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Supreme Court of the United States.

OCTOBER TERM, 1913, No. 460.

(Originally No. 975, October Term, 1912.)

HENRY D. HOTCHKISS, as Trustee in Bankruptcy of Henry S. Haskins and others,

Appellant,

against

THE NATIONAL CITY BANK OF NEW YORK,

Appellee.

BRIEF FOR APPELLEE.

JOHN A. GARVER,
Solicitor and Counsel for Appellee.

C. G. Burgoyne, 72 to 78 Spring Street, New York.

Supreme Court of the United States.

OCTOBER TERM, 1913. No. 460.

(Originally No. 975, October Term, 1912.)

HENRY D. HOTCHKISS, as Trustee in Bankruptcy of Henry S. Haskins, Henry Leverich, individually, and Fannie G. Lathrop, special partner, and as co-partners trading under the firm name of Lathrop, Haskins & Co.,
Appellant,

AGAINST

THE NATIONAL CITY BANK OF NEW YORK,
Appellee.

Brief for Appellee.

Statement.

Appeal by the complainant from so much of a decree of the United States Circuit Court of Appeals for the Second Circuit as affirmed a portion of a final decree of the District Court of the United States, for the Southern District of New York. The portion of the final decree objected to by the complainant directed the return of certain securities by the defendant to the complainant, without requiring the defendant to pay, in addition, a sum representing the depreciation in the

market value of the securities between January 19, 1910, the date when they were received by the defendant, and April 11, 1912, the date of the entry of the final decree.

On January 15, 1912, an interlocutory decree was entered in favor of the complainant, setting aside, under Section 60 of the Bankruptcy Law, a transfer of securities delivered by the bankrupts to the defendant on January 19, 1910 (fols. 1125-35). It was referred to a Special Master, to take and state the account.

The complainant endeavored to surcharge the account with the amount that the securities had declined subsequent to their delivery (fols. 1157-64). Upon the hearing before the Special Master, it was shown that the Receiver in Bankruptcy (Mr. Hotchkiss, who was afterwards appointed Trustee), had, on January 20, 1910 (the day after the securities were received by the Bank), directed the defendant "not to sell or otherwise dispose of any of the collateral" held by it (fols. 1168-9).

On March 18, 1910, the Receiver again wrote a letter to the Bank, containing the following statement (fols. 1199-1200):

> "I think your suggestion to Mr. Barnaby, that you be permitted to use your own good judgment as to when you shall liquidate the securities held by you for account of collateral loans to Messrs. Lathrop, Haskins & Co., is a very good one, and I thank you for making it.
>
> "With respect to the securities delivered to you upon the 19th of January, and which were the subject of a recent demand on my part, I think it might *also* be well to get the benefit of the most advantageous market. But this, perhaps, ought to be covered by a stipulation approved by your attorneys. I would suggest reference of the matter to them, to the end that we may arrange a course for the best interest of all concerned."

The Bank then suggested that Mr. Hotchkiss should prepare a form of stipulation that would be satisfac-

tory to him (fols. 1203-4). The stipulation was thereupon prepared by the Receiver's counsel (fols. 1206-7); and, on April 5, 1910, it was signed, without change. It contained the following provision (fol. 1189):

> "It is hereby stipulated as follows: That the said securities appearing in Exhibit A may be sold by the National City Bank, at the best price obtainable, *at such times as may seem best to the officers of the said National City Bank.*"

It was further provided that the rights of the parties should not be affected by a sale of the securities, but that the proceeds should stand in their place (fol. 1191).

This stipulation was duly approved by the Court (fol. 1196).

The Special Master refused to hold the defendant liable for the decline in the market value of the securities, and overruled the objections filed to the account (fols. 1213-1277); and, upon a motion by the complainant to disallow his report and for judgment accordingly, the report was confirmed by his Honor, Judge Hand (fols. 1259-67); and the final decree was thereupon entered (fols. 1269, 1281), which was affirmed by the Circuit Court of Appeals (p. 342).

POINTS.

FIRST.

If the final decree should be reversed upon the defendant's appeal now pending in this Court (No. 459, October Term, 1913), the complainant's appeal from a portion of the decree would, of course, fall.

SECOND.

The conduct of the parties and the terms of the stipulation make it clear, beyond the possibility of a doubt, that the sale of the securities was left entirely to the judgment and discretion of the Bank; and its good faith in not selling the securities is not questioned. It is evident that the complainant was unwilling to direct the securities to be sold, or even to recommend that course. He, very properly, preferred to rely upon the experience and judgment of the officers of the Bank, who had a more direct personal interest than the Receiver in realizing the highest price for the securities. It was, therefore, stipulated that they *might* be sold, "at the best price obtainable, at such times as might seem best to the officers of the said National City Bank (fol. 1189)."

Is there the slightest ambiguity in this language? Judge HAND thought that the matter could not have been expressed more plainly (fols. 1261-2). But even if there were any ambiguity in the language, it would have to be construed most strongly against the complainant, whose counsel drafted the instrument.

Nothing could be added, except by way of circumlocution, to the very clear exposition of the subject contained in Judge HAND's opinion (fols. 1260-7).

The inequitable character of the appellant's claim is glaringly obvious in the contention (Assignment of Errors, No. 4, p. 348) that the market value of the securities on January 19, 1910, should be taken, although, on the very next day, the complainant positively directed the Bank not to dispose of the securities (fols. 1168-9).

THIRD.

The portion of the decree appealed from should be affirmed, unless the decree, as a whole, should be reversed under the defendant's appeal.

Washington, October, 1913.

JOHN A. GARVER,
Solicitor and Counsel for Appellee,
55 Wall Street,
New York City.

Supreme Court of the United States.

OCTOBER TERM, 1912.

~~Nos. 974 and 975~~.

459 & 460

HENRY D. HOTCHKISS, as Trustee in Bankruptcy of Henry S. Haskins, Henry Leverich and Fanny G. Lathrop, individually and as copartners under the firm name of Lathrop, Haskins & Company,
Complainant, Appellee and Appellant,

against

NATIONAL CITY BANK,
Defendant, Appellant and Appellee.

Sirs.—Please take notice that a motion will be made, for the reasons hereto annexed, before the United States Supreme Court, at a Session thereof to be held at the Capitol, in the City of Washington, D. C., on Monday, the 7th day of April, 1913, at 12 o'clock noon, or as soon thereafter as counsel can be heard, for a rule or order advancing this

cause and setting it down for hearing and argument on a day to be fixed by the Court.

Dated New York, March 28th, 1913.

Yours, &c.,

ABRAM I. ELKUS & WILLIAM A. BARBER,
Attorneys for Complainant,
Appellee and Appellant.
Office & Post Office Address,
No. 170 Broadway,
Borough of Manhattan,
City of New York.

To. Messrs. SHEARMAN & STERLING,
No. 55 Wall Street,
New York City.
Attorneys for Defendant,
Appellant and Appellee.

SUPREME COURT OF THE UNITED STATES.

HENRY D. HOTCHKISS, as Trustee in Bankruptcy of Henry S. Haskins, Henry Leverich and Fanny G. Lathrop, individually and as copartners under the firm name of Lathrop, Haskins & Company, Complainant, Appellee and Appellant, *against* NATIONAL CITY BANK, Defendant, Appellant and Appellee.	Petition.

Now comes HENRY D. HOTCHKISS, Trustee in Bankruptcy of the above-named Bankrupts, the complainant, appellee and appellant of record herein, by ABRAM I. ELKUS and WILLIAM A. BARBER, his counsel, and moves this Honorable Court to advance the above-entitled cause upon the calendar and to set the same down for argument for a day certain, because of the existence of certain special and peculiar circumstances, as follows:

First.—Complainant is the sole Trustee in Bankruptcy of the above-named Bankrupts, against whom a petition in involuntary bankruptcy was filed on January 19th, 1910. Complainant was thereupon appointed Receiver in Bankruptcy of said Bankrupts and continued to act as such until April 17, 1910, when he was duly elected Trustee in Bankruptcy of said Bankrupts, in which capacity he has ever since continued to act.

Second.—The above-entitled cause was brought to set aside the transfer of certain securities by said bankrupts to the defendant on the ground that such act was a preferential transfer. Decision was rendered in favor of complainant in the United States District Court for the Southern District of New York, which decision was thereafter affirmed by the United States Circuit Court of Appeals for the Second Circuit on or about the 11th day of April, 1912. From this decision cross appeals have been taken to this Court, defendant having appealed from the decision as a whole and complainant from certain minor provisions thereof. These appeals are now pending and are Nos. 974 and 975 upon the October-1912 calendar of this Court. These appeals will not be reached for argument in their regular course for at least two years and possibly not for a longer period.

Third.—Complainant, as sole Trustee in Bankruptcy of the above-named bankrupts, has administered the affairs of the said bankrupt estate ever since his election as such Trustee, and is familiar with all matters pertaining to said bankruptcy. Complainant has thus far received only nominal compensation for these services, which have extended over a period of three years. In November, 1911, complainant was elected a Justice of the Supreme Court of the State of New York and took office on January 1, 1912. On January 1, 1913, he was designated by the Governor of New York to act as a Justice of the Appellate Division of said Supreme Court and is now so acting. As such Justice complainant is required to pass upon various appeals which may be taken from the Supreme Court and from other lower courts of record to said Appellate Division.

Fourth.—The above-entitled cause involves about \$150,000, which, by the terms of the decision of the District Court and and the Circuit Court of Appeals in complainant's favor, would be available for distribution to the creditors of the above-named bankrupts, who are over 150 in number. By reason of the appeal taken by the defendant to this Court the distribution of this amount will necessarily be delayed for probably two years or more. The pendency of this appeal is the principal obstacle in the way of closing up said bankrupt estate and a long delay in deciding the appeal will inevitably work a great hardship upon the creditors of said bankrupts. Complainant is also anxious to be relieved of his trusteeship as soon as possible, because of his official position as a Justice of the New York Supreme Court.

Because of the foregoing facts the undersigned prays this Court for a rule or order advancing said cause, pursuant to subdivision 7 of Rule 26 of this Court, and setting the argument of the appeal herein for some day in the month of October, 1913.

Respectfully submitted,

Abram I. Elkus & William A. Barber,
Attorneys for Complainant,
Appellee and Appellant,
No. 170 Broadway,
New York City.

FILED

HENRY

HENRY

BRIEF

INDEX.

CITATIONS.

In the Supreme Court of the United States,

OCTOBER TERM—1913.

THE NATIONAL CITY BANK OF NEW YORK, Appellant, *against* HENRY D. HOTCHKISS, as Trustee in Bankruptcy, of HENRY S. HASKINS, *et al.*, Appellee.	*No. 974.*
HENRY D. HOTCHKISS, as Trustee in Bankruptcy, of HENRY S. HASKINS, *et al.*, Appellant, *against* THE NATIONAL CITY BANK OF NEW YORK, Appellee.	*No. 975.*

Brief for Complainant, Appellee and Appellant.

Statement of Case.

These are cross appeals from a decree of the United States Circuit Court of Appeals for the Second Circuit, which affirmed a decree of the District Court for the Southern District of New York (*p. 342*).

The defendant, a bank, loaned the bankrupt, a firm of stock brokers, a large sum of money, and later in the same day, with full knowledge, it took the securities for which suit is brought from the defendant, subsequent to the announcement of the latter's suspension, and while a petition in bankruptcy was being prepared, which was also filed the same afternoon (*fols. 85–6*).

The defendant claims that it made the loan to enable the bankrupt to meet its current obligations, and that it was in accordance with general usage that loans thus made should be paid during the day by securities "deliverable by the borrower on the same day" or should be secured by securities which the borrower realized from the proceeds of the loan (*fols. 58–60*).

Suit was brought by the trustee in bankruptcy under § 60 of the Bankruptcy Act to set aside the transfer to the defendant as a voidable preference (*fols. 36–9*).

The District Court for the Southern District of New York by its decree filed April 11th, 1912, affirming the report of a Special Master, directed that the defendant deliver to the complainant the securities in question, with the interest and dividends received thereon from the date of delivery, and in default thereof that the complainant have judgment against the defendant for $161,740.62, with interest. The defendant appealed to the Circuit Court of Appeals from so much of the decree as adjudged the transfer to be a preference, and the complainant appealed from the measure of damages adopted in the decree, claiming a larger recovery.

The Circuit Court of Appeals affirmed the decree of the District Court and both appeals were brought into this Court (*pp. 343, 348*).

Statement of Facts.

Lathrop, Haskins & Company were engaged in business as stock brokers in the City of New York for a number of years prior to January 19th, 1910. Henry S Has-

kins was the Stock Exchange member of the firm (*fol. 404*).

Situation Causing Failure.

On March 1st, 1909, this firm, with eight other Stock Exchange houses, and James R. Keene, formed a pool or joint venture for the purchase and sale of the common stock of the Columbus & Hocking Coal & Iron Company. The holding capacity of this pool at any one time was 20,000 shares. Lathrop, Haskins & Company participated to the extent of 10,500 shares. This is called "Pool No. 1." It originally was to expire on September 1st, 1909, but by agreement was extended to March 1st, 1910 (*fols. 327–9*).

In August, 1909, "Pool No. 2" was organized for the same purpose between Lathrop, Haskins & Company, seven other Stock Exchange houses and James R. Keene. The capacity of this pool was also 20,000 shares and it was to expire on March 1st, 1910. Lathrop, Haskins & Company participated in this pool for 2,000 shares (*fols. 328–9*). Their customers participated through the firm (*fol. 334*). Keene was the manager of both pools (*fol. 328*).

On January 19th, 1910, Hocking Coal & Iron stock had not been sold below 80 since November, 1909 (*fol. 361*). Profitable oil wells had recently been opened on the property (*fol. 860*). At the opening of the market on that day Lathrop, Haskins & Company were interested very heavily in this stock (*fol. 221*). This was well known to defendant (*fol. 609*). This stock was up as collateral security for loans with banks and trust companies (*fol. 363*).

Financial Condition of Lathrop, Haskins & Company on January 19th, 1910, at 10 a. m.

At the opening of business at 10 a. m. on January 19th, 1910, Lathrop, Haskins & Company were solvent by a large surplus. The financial statement and balance sheet put

in evidence by the defendant shows that at that time Lathrop, Haskins & Company had a net surplus of assets over liabilities amounting to over $400,000 (*Defendant's Exhibit A*, *fols. 297-9, 303*).

The Loan and Bank Account.

Shortly after 10 A. M. that morning the firm sent its demand notes to the National City Bank for $300,000 and $200,000 respectively (*Complainant's Exhibits 11 and 12*, *fols. 438-443*).

These demand notes constituted the sole agreement between Lathrop, Haskins & Company and the defendant (*fol. 450*). No securities were delivered therewith. The demand notes were received by the bank and $500,000, their amount, was credited to the account of Lathrop, Haskins & Company and entered upon their passbook (*fol. 619*). Similar demand notes for various amounts were for some period of time prior to January 19th, 1910, sent to the bank daily by Lathrop, Haskins & Company, the account being credited with the amount thereof. These notes were paid at the close of each business day by Lathrop, Haskins & Company sending their check for the full amount of that day's note, and the bank would return the note stamped "PAID" (*fols. 411-12*).

Lathrop, Haskins & Company had no account with any other bank; they deposited all moneys they received in their business, from whatever source derived, with the defendant and it was credited to the firm in the same account (*fols. 413, 434, 619*).

At the opening of business on January 19, 1910, Lathrop, Haskins & Co. had a credit balance with the defendant of $54,319.98 (*fols. 494, 421*). To this was added the $500,000 credited by the bank that morning for the two demand notes (*fol. 494*). There were also credited to this account various deposits made by Lathrop, Haskins & Co. during the day amounting to $374,845.80 (*fols. 466, 494*).

About twelve o'clock noon on January 19, 1910, the condition of their account was as follows :

Balance from January 18, 1910		$54,319.98
Loan	$200,000 / $300,000	500,000.00
Deposit		100,600.00
"		83,400.00
"		31,162.50
"		2,200.00
"		127,000.00
"		200.00
"		30,283.30
		$929,165.78
Certified checks drawn		535,920.74
BALANCE (*fols. 421, 466, 493–4, 499*)		$393,245.04

Lathrop Haskins & Co. early in the morning of the 19th drew on the defendant the following checks which they caused to be certified (*fols. 391–2*):

Payee.	*Amount.*
Liberty National Bank	$100,095.81
Guaranty Trust Company	100,011.11
First National Bank	200,340.24
Brooklyn Trust Company	100,273.58
A. J. Elias & Co.	17,500.00
A. J. Elias & Co.	17,700.00
	$535,920.74

The checks payable to banks and trust companies were used to pay moneys borrowed by Lathrop, Haskins & Co. from those banks, and these payments released securities that were pledged as collateral (*fol. 394*). Some of these securities were used to make deliveries on sales made the preceding day and the moneys received upon such deliveries were deposited with the defendant from

time to time (*fol. 433*). Lathrop, Haskins & Co. also deposited throughout the day all sums of money received from other sources in the business and all of the deposits were placed to the credit of this account (*fols. 434–5*).

Drop in Hocking Stock, Cause of Failure.

Hocking Stock which that morning opened above 80 (*fol. 361*), around 11 o'clock began rapidly to decline. The decline continued until it reached 25 around 2:15 P. M., when it rallied and went to 32½ and closed at 33 (*fols. 309, 310*).

Suspension of Lathrop, Haskins & Co.

About 12 o'clock noon Mr. Haskins acting at the direction of his attorney Mr. Little sent a letter to the New York Stock Exchange stating that they were "unable to meet their obligations" (*fols. 212, 199*). This letter was received at 12:08 and read at 12:11 by the president of the Stock Exchange from the rostrum on the floor of the Exchange, in the presence of about 250 members (*fols. 196–7, 201–3*). The announcement of the suspension at once came out on the ticker (*fol. 594*).

Letter to National City Bank.

At the same time Mr. Haskins sent a letter by messenger to the National City Bank stating that they "were forced to suspend. Assignee will be named later" (*fols. 213, 279*). This letter was delivered to a gentleman sitting at a desk in defendant's office who came back and said all right (*fols. 281, 285*).

Officers of Defendant Alarmed at Drop, go to Office of Lathrop, Haskins & Company.

Mr. Albeck, the assistant cashier of the bank, noticed on the ticker the decided fall in the Hocking stock in which he knew Lathrop, Haskins & Co. were heavily interested,

and which he knew was one of their specialties (*fols. 608–9*). He thought the situation very alarming (*fol. 607*), and at once called the attention of Mr. Kilburn, the vice-president, to this heavy fall in Hocking stock, telling him that the bank had made to Lathrop, Haskins & Co. that morning a loan of $500,000, and that the account of Lathrop, Haskins & Co. was drawn beyond actual deposits to the extent of about $117,000 (*fols. 589, 590*). At that time the account of Lathrop, Haskins & Co. showed a credit balance of over $390,000 as against which there were, however, their demand notes for $500,000 (*fol. 496*). Lathrop, Haskins & Co. had been making deposits from early in the day and it was usual to allow them until 3:00 P. M. to repay the loan (*fols. 625, 626*). Nevertheless, Messrs. Kilburn and Albeck did not wait until 3:00 P. M. to give Lathrop, Haskins & Co. an opportunity to take up their notes nor did they telephone the firm, as was usual if the deposits were not satisfactory (*fol. 625*) but they went at once to the office of Lathrop, Haskins & Co. (*fols. 545–6*).

Their purpose was to protect the bank in case Lathrop, Haskins & Co. "had to fail" or go into bankruptcy (*fol. 591*).

AT THE OFFICE OF LATHROP, HASKINS & COMPANY ; COMPLETE FAILURE.

They found the office of Lathrop, Haskins & Co. in a state of great excitement, "first one man and then another—a dozen talking at the same time" (*fol. 460*). They knew that Lathrop, Haskins & Co. were in financial trouble (*fol. 473*), and that they were on the verge of some kind of bankruptcy or insolvency (*fol 473*).

They were told by Mr. Little, the attorney of the firm, that Lathrop, Haskins & Co. were insolvent and that a petition in bankruptcy was filed or was being filed against them (*fol. 215*). That they could not pay anybody (*fol. 216*). Mr. Little explained to them the whole situation

about the pool, the financial condition, and the enormous loss, about $2,000,000 (*fols. 221–2*).

Mr. Kilborn and Mr. Albeck testified that while at the office of Lathrop, Haskins & Co. they learned that the suspension of the firm had been announced upon the Stock Exchange (*fols. 482, 490, 594*), and were told that Lathrop, Haskins & Co. were unable to meet their obligations (*fol. 482*); that they were absolutely forced to the wall (*fol. 492.*) They knew for a certainty that Lathrop, Haskins & Co. were unable to meet their obligations at that time and it was questionable whether they would be able to do so in the future (*fol. 593*). They were told and understood that Lathrop, Haskias & Co. by what had happened would be forced to the wall and would fail (*fol. 598*) and that the appointment of a receiver had been applied for but had not yet been granted (*fol. 609*).

The officers of the bank asked for money or securities to make up certifications (*fol. 215*). There seems to be some doubt as to whether they asked for money or securities or merely securities (*fols. 483, 603*).

Delivery of Securities about 2:15 p. m.

After two hours of discussion the securities in suit were delivered to Mr. Kilborn (*fols. 216, 454*). Mr. Little, who directed the delivery of the securities, testified that his motive in doing so was to preserve the bank's friendship and good will and that when he delivered the securities to Mr. Kilborn he told him it was a clear preference, preferring them over other creditors, and that it was doing something that ought not to be done, but that the securties could not be in a safer place than in the City Bank (*fols. 217, 218, 222*).

Mr. Little, the attorney for Lathrop, Haskins & Co., who was present throughout the entire interview with the officers of the bank, testified that the securities were delivered after 3:00 p. m. (*fol. 239*).

According to Mr. Kilborn the securities were delivered

about 2:30 P. M. (*fol. 456*). Mr. Albeck testifies that he and Mr. Kilborn had returned with the securities by 2:30 P. M. (*fol. 552*). The officers of the bank gave a receipt specifying the securities and the number thereof (*fols. 445–6*).

The securities were when delivered of the value of $154,-300, and the claim of the bank against Lathrop, Haskins & Co. amounted to $116,166.69 (*fols. 130, 131, 191*).

The securities were demanded, delivered and accepted without discrimination or reference as to their source or as to the source of the value represented therein (*fols. 396–400*).

Where Lathrop, Haskins & Co. Obtained the Securities Delivered.

Of the securities delivered the following had not on that day been under pledge and hence bear no relation to the loan made by defendant (*fol. 397*):

200 shares Col. & Hocking Coal and Iron, com.
50 shares Miss., Kan. & Tex. R. R. Co., com.
50 shares Anaconda Copper Co., com.
50 shares Nat. Lead, com.
50 shares U. S. Steel Corporation, com. (*fol. 397*).

Of the remainder of the securities delivered the following had been released from pledge by the substitution in the pledge of securities which had been released from pledge by checks drawn on defendant (*fols. 400–1*).

It is unknown, however, to what extent these securities had been pledged and hence unknown to what extent they were so redeemed by substitution. It is also unknown to what extent the securities substituted in the pledge, had been pledged and to what extent redeemed by check drawn on defendant.

300 shares Chic., R. I. & Pac. Ry. Co., com.
100 " Consol. Gas Co., com.
100 " Amer. Smelting & Refining Co., com.
100 " New York Central & Hudson R. R. Co.

The remainder of the securities delivered had been released from pledge by the delivery of checks drawn on defendant against the bank balance, deposit and loan.

But it is unknown to what extent they had been pledged and hence to what extent they were thus released. And it is unknown to what extent the checks by which they were released were drawn against the bank balance and deposits.

Financial Condition of Lathrop, Haskins & Co. when Securities were Delivered.

There is some difference in the testimony as to the exact time when the securities were delivered. Mr. Little places it after 3:00 P. M. (*fol. 239*). Mr. Kilborn at after one o'clock and before 2:30 P. M. (*fol. 456*), and Mr. Albeck at prior to 2:30 P. M. (*fol. 552*). We have, therefore, taken 2:15 P. M. on January 19, 1910, as the time when the securities were delivered by Lathrop, Haskins & Co. and received by defendant. At that time the firm and the individual members thereof were clearly insolvent. The financial standing of the firm, as shown from the books, is as follows :

Liabilities	$1,936,035.64
Assets	1,334,875.31
Excess of liabilities	$601,160.33

over assets as shown on the books (*fol. 192*).

The actual extent of the insolvency is shown to be much greater than this by reason of the worthless character of certain accounts carried on the books as assets. The defendant's experts examined the books of the firm and no fault has been found with this statement of the financial condition at that time, 2:15 P. M. (*fols. 105–6*).

It is conceded that Mr. Haskins and Mr. Leverich the only general partners were insolvent (*fols. 447,863*). Further details as to the financial condition of Lathrop, Haskins & Co. on January 19, 1910, will be taken up in Point I.

Bankruptcy Proceedings and Adjudication.

At 4:10 P. M. of January 19th, within two hours after Mr. Albeck, the assistant cashier of the defandant, testified that the securities were delivered, and less than one hour after the bank received the securities, according to the testimony of Mr. Little, a petition in involuntary bankruptcy was filed and thereafter Lathrop, Haskins & Co. and the individual members thereof were duly adjudicated bankrupts (*fol. 85*).

The schedules show an excess of liabilities over assets of $1,018,121.37 (*fols. 98, 103*). The claims filed with the referee and allowed are also in evidence. Unsecured claims amounting to $2,369,384.29 and secured claims amounting to $738,302.12 have been filed and allowed (*fols. 356, 884, 885*).

Issues.

The complainant contends that the transfer of the securities by Lathrop, Haskins & Co. to the defendant on the afternoon of January 19, 1910, constitutes a preference, voidable under Section 60 of the Bankruptcy Act; that the transfer was made within four months of the filing of the involuntary petition against Lathrop, Haskins & Co. when that firm and the individual members thereof were insolvent, and was without present fair and valuable consideration; that the defendant had reasonable cause to believe that said firm was insolvent and that a preference was thereby intended; and that the effect of the transfer was to enable the defendant to realize a greater percentage of its claim than any of the other creditors of the firm of Lathrop Haskins & Co. or the individual members thereof, of the same class. The answer of the defendant admits the transfer and puts in issue all the other material elements of a voidable preference under the Bankruptcy Act.

In addition the defendant, has alleged in paragraph XI of its answer, a custom or usage " that loans thus made should either be paid off during the day out of the proceeds of

securies which were deliverable by the borrowers on the same day, or in the event of payment not being made in full, the remainder of such loan *should be secured* before the close of business on the same day, by securities obtained by the said firm with the proceeds of such loan" (*fol. 59*).

As to this alleged custom or usage the complainant contends:

1st. That the defendant has failed to establish the custom or usage set up in its answer.

2nd. That the defendant has failed to establish any valid custom or usage that will be recognized by the courts.

3rd. That the custom or usage claimed by the defendant is not competent or admissible, because it directly tends to change and vary the terms of the written contract of the parties.

4th. That the custom or usage is not operative to give the bank a lien, equitable or otherwise, upon the securities at any time prior to the actual delivery.

5th. That the principle of equitable subrogation is not applicable to this case.

Assignment of Errors.

As to the measure of damages tho complainant contends:

(1) That he is entitled to recover the value of the securities at the date of delivery with interest to the date of the final decree April 11, 1912, and interest on the judgment.

(2) That the decree is incorrrect in any view and fails to follow the report of the Master in that it does not allow interest on dividends received, and the alternative recovery is nearly $1,000 too small based on the Master's report.

(3) Since the value of the stocks has depreciated since the date of the trial and since the date of the final decree, this Court should direct that the defendant be charged with such depreciation.

POINTS.

I.

Lathrop, Haskins and Co. and its individual members were insolvent on the afternoon of January 19th, 1910, when the securities were delivered to the defendant.

Mr. Little the attorney for Lathorp, Haskins & Co. who finally directed the delivery of the securities places the time as after 3:00 P. M. His testimony is direct, detailed and convincing (*fol. 240*). Mr. Kilborn, vice-president of the bank, does not think he can tell the time, but places it as after 1 P. M., and earlier than 2:30 P. M. (*fol. 456*). Mr. Albeck, the assistant cashier, places the time at about 2:00 P. M. (*fol. 594*).

We have taken the time when the securities were delivered as 2:15 P. M. Hocking stock had been down to 25 and rallied around 2:15 P. M., and later went to 32½ (*fol. 310*). In ascertaining the financial condition we have taken Hocking stock at 32 that being its market value on the New York Stock Exchange at that time (*fols. 310, 318*).

In ascertaining the value of securities, those that were dealt in on the Exchange were valued at prices taken from the Stock Exchange lists of sales, giving the market quotations of those securities on January 19th, 1910, at 2:15 P. M. Those that were not dealt in on the Exchange were valued at the prices which they sold for at that time off the Exchange, as shown by "The Evening Sun" of January 19, 1910 (*fols. 114–5*).

The defendant "concedes that the securities, in so far as they were listed on the New York Stock Exchange, were valued at the market quotation which prevailed at 2:15 P. M. on that date, and that the securities which were not listed were reasonably worth the valuations placed upon them" (*fol. 287*).

In arriving at the amounts due to and from customers

and banks where securities were pledged as collateral, the account was closed out as of 2:15 P. M. (*fols. 324, 344-5, 383, 425*). But where the loan was sold out on that day the price which the bank actually received was taken (*fol. 345*).

The value of all the securities which Lathrop, Haskins & Company had on hand has fallen somewhat since January 19, 1910 (*fol. 424*). Hocking stock after its collapse to 25 on January 19, steadily declined to 18 in February, then to 14 in March, and in the summer to 5, and the last sale was at 2 (*fol. 423*). Thus, in taking the value of the stocks as of 2:15 P. M. on January 19, we have been most fair to defendant.

FINANCIAL CONDITION OF LATHROP, HASKINS & CO. ON JANUARY 19, 1910, AT 2:15 P. M.

The direct testimony as to the financial condition of the bankrupts at 2:15 P. M. is summarized as follows (*fols. 301–3*):

Due from customers	$705,618.10
Due from members of N. Y. Stock Exchange, pool subscribers	66,390.16
Due from members of N. Y. Stock Exchange (other transactions)	2,190.30
Securities on hand	160,828.00
Securities with National City Bank	154,300.00
Office furniture	952.25
Money loaned	63,864.84
Petty cash	131.66
Due from Banks and Trust Cos	99,600.00
Membership N. Y. Stock Exchange	75,000.00
	$1,329,875.81

Liabilities.

Due to customers..........................	$747,361.50
Due to members N. Y. Stock Exchange.....	858,813.95
Due to Banks and Trust Cos...............	213,693.50
Due to National City Bank................	116,166.69
	$1,936,035.64
Excess of liabilities over assets as shown on books................................	$606,160.33

To the value of securities on bond must be added $5,000, the value of 79 shares Columbus & Hocking Coal & Iron Co. preferred (*fol. 289*). The securities delivered to the defendant were of the value of $154,300.

BAD ACCOUNTS.

From the amount due from customers must be deducted the following worthless accounts:

E. S. Lucas....................	$8,376.50	(*fol. 146*).
L. Bernheimer, Trustee.........	3,355.37	(*fol. 153*).
John F. Alexander............	8,470.40	(*fol. 245*).
Allela L. Dunn	6,774.18	(*fol. 251*).
Crank M. Cronise..............	7,955.27	(*fol. 256*).
Moses L. Eiseman..............	14,757.88	(*fols. 262–3*).
Vera B. Lavergne..............	4,808.08	(*fol. 270*).
O. B. Smith	15,030.12	(*fol. 354*).
Carrie H. Midgely.............	4,024.52	(*fol. 293*).
E. J. Garvan..................	9,643.62	(*fol. 488*).
	$83,195.94	

CLAIM AGAINST COLUMBUS & HOCKING CLAY CONSTRUCTION COMPANY.

This claim, amounting to $229,060.41, is included in the foregoing statement of assets (*fol. 139*). The company is in the hands of a receiver and has no assets, and the claim is worthless (*fols. 520–1*).

Doubtful Accounts.

The following claims are also included as assets in the foregoing statement (*fols. 138–42*). While these claims may not be absolutely worthless, yet no definite value can be placed upon them, and an allowance must be made for them in determining the true financial condition:

Wallace Irwin (*fol. 157*)..........	$1,011.78
Oliver Gildersleeve (*fol. 162*)......	2,851.46
James R. Keene (*fol. 164*).........	62,817.68
Louis Breslauer (*fol. 165*).........	3,629.05
C. T. Willard (*fol. 166*)	6,482.16
H. O. Seixis (*fol. 166*)............	17,696.37
Herman Weiss (*fol. 168*)..........	868.00
Mrs. J. B. Bruyn (*fol. 170*).	2,851.46
W. C. Curtis (*fol. 170*)	2,851.47
W. F. Osborne (*fol. 170*)	14,257.32
Berthold Levi (*fols. 165–265*)......	198,175.16
	$313,491.90

Insolvency of the Individual Members of Lathrop, Haskins & Co.

It is conceded that Henry Leverich, a member of the firm of Lathrop, Haskins & Co., is insolvent and has no assets, and that on January 19th, 1910, he had no assets but had individual liabilities of $100,000 (*fol. 447*). It is also conceded that at the time the defendant received the securities in controversy Henry S. Haskins, the other general partner of the firm of Lathrop, Haskins & Co., had no assets individually, except his seat on the New York Stock Exchange (*fol. 864*). This seat in the Stock Exchange, valued at $75,000, has already been included as a firm asset (*fol. 302; Complt.'s Exhibit 10*).

Petition in Bankruptcy and Adjudication.

The involuntary petition in bankruptcy was filed January 19th, 1910, at 4:10 P. M., less than two hours after the bank received the securities (*Complt.'s Exhibit 1; fol. 87.* An order was entered thereon adjudicating Lathrop, Haskins & Co. and its individual members involuntary bankrupts (*Bill, Par. 1, conceded by defendant, fol. 80*).

Allowed Claims Filed in Bankruptcy Proceedings.

One hundred and fifty-four claims, amounting to $2,369,384.29, have been filed by creditors with the referee, and have been allowed by him.

Five secured claims, amounting to $738,302.12, have been filed by banks and trust companies (*fols. 884–5, 356*).

Schedules in Bankruptcy.

The schedules in bankruptcy of Lathrop, Haskins & Co., which are in evidence, show an excess of firm liabilities over firm assets of $1,018,121.37 (*Complt.'s Exhibit 2; fols. 99, 103*).

Summary.

1. Excess of liabilities, as shown by the books of Lathrop, Haskins & Co., on January 19, 1910, at 2:15 P. M., as set forth in Complt.'s Exhibit 10	$606,160.33
From this should be deducted for 79 shares preferred stock Columbus & Hocking & Iron Co	5,000.00
	$601,160.33
To this should be added bad accounts due from customers	83,195.84
and worthless claim against the Columbus & Hocking Clay Construction Company ..	$229,060.41
excess of liabilities over assets at that time of.	$913,416.58
Allowance should be made for disputed accounts	313,491.90

2. The individual members of Lathrop, Haskins & Co. were conceded to be insolvent on January 19th, 1910, at 2:15 P. M.

3. The petition in bankruptcy by which Lathrop, Haskins & Co. and its individual members were subsequently adjudicated involuntary bankrupts was filed at 4:10 P. M. that afternoon, less than two hours after the delivery of the securities to the defendant.

4. Unsecured claims aggregating upwards of $2,300,000 have been filed against Lathrop, Haskins & Co. and allowed by the referee, and claims of upwards of $700,000 have likewise been filed against the bankrupt estate.

5. Schedules in bankruptcy sworn to by the bankrupts show that the firm was insolvent on the 19th day of January, 1910, at 2:15 P. M., to the extent of upwards of $1,000,000.

II.

The transfer of securities by Lathrop, Haskins & Company to defendant was within four months of the filing of the petition in bankruptcy and was without a present fair and valuable consideration. The defendant thus obtained a greater percentage of its claim than any other general creditor of Lathrop, Haskins & Company.

It has been shown under Point I that on the afternoon of January 19th, 1910, when the securities were transferred, Lathrop, Haskins & Company, and its individual members, were insolvent to the extent of at least $900,000. The involuntary petition in bankruptcy was filed that very afternoon.

It is undisputed that the securities valued at $154,300 were the property of Lathrop, Haskins & Company.

The loan of $500,000 by the defendant to Lathrop,

Haskins & Co. was made on the morning of January 19th, 1910. At that time their demand notes for $300,000 and $200,000 were delivered to the bank, and the firm was given credit therefor on the books of the bank and in the pass-book of the firm (*fols. 388, 439, 450, 619*). At substantially the same time Lathrop, Haskins & Co. drew the checks on the defendant which the defendant certified (*fols. 390, 437, 461*).

The securities were delivered on the afternoon of that day to take up these notes (*fol. 483*).

The securities transferred are more than sufficient in value to pay the entire amount of the claim of the defendant against Lathrop, Haskins & Company on January 19th, 1910, amounting to $116,166.69. It follows, therefore, as a matter of course, that the effect of the transfer was to enable the National City Bank to obtain a greater percentage of its claim against the firm of Lathrop, Haskins & Company than any of the other creditors of the same class.

Crooks vs. *People's National Bank, 46 App. Div., 335.*

In *Continental Trust Co.* vs. *Chicago Title Co. (229 U. S., 435)*, the bankrupt had certain certificates of deposit placed as security for contracts made on the Board of Trade. The bank which issued such certificates, and Anderson & Co. made arrangements with the bankrupt whereby Anderson & Co. were substituted in said contracts to the position of the bankrupt, and they depositing their own security released the trust certificates to the defendant bank which applied them to its general account with the bankrupt. This was all one transaction. It was found, as a fact, that but for this arrangement the contracts and the certificates would have been lost to the estate and hence there was no diminution of the estate.

In the present case it is impossible to consider the

making of the loan in the morning when the bankrupts were clearly solvent, as one transaction with the taking of the securities by the bank in an effort to protect itself in the afternoon when insolvency was known. There was no contract for a lien on securities in the possession of the bankrupts. There was no custom contemplating such a lien, and all the acts of the parties negative such an idea. A delivery of securities was not contemplated, and had never previously occurred in the dealings of the parties. The intention was that the brokers were to pay by check and not to force a loan extending beyond the day upon the bank. The claims of others, including banks, had arisen between the loan and the seizing of the securities. There is no possible way of telling to what extent any of the securities seized were cleared by the loan made by defendant.

There was in the case at bar a clear depletion of the estate to the extent to which the bank seized security for an unsecured loan. The advantage to the bank measured the loss to the estate.

III.

Defendant had reasonable cause to believe that a preference was intended.

The knowledge on the part of the defendant of the insolvent condition of Lathrop, Haskins & Co., on the afternoon of January 19th, 1910, when the securities were transferred, has been established by the complainant with a positiveness that admits of no doubt.

Knowledge of such insolvency is brought home to the bank:

By the announcement of the suspension of Lathrop, Haskins & Co. on the New York Stock Exchange;

By the letter of Lathrop, Haskins & Co. to the defendant, notifying it that they were forced to suspend;

And by the occurrences in the office of Lathrop, Haskins & Co. on the afternoon of January 19th, 1910, before the securities were delivered to the bank, as testified to by Mr. Kilborn, vice-president of the National City Bank, Mr. Albeck, its assistant cashier, and Robert F. Little, the attorney for Lathrop, Haskins & Co.

Announcement of Lathrop, Haskins & Company's Suspension on New York Stock Exchange.

At 12:11 P. M. on January 19th, 1910, the suspension of Lathrop, Haskins & Co. was announced on the floor of the New York Stock Exchange. Their letter to the Secretary of the Exchange, informing him of their inability to meet their obligations was at that time read from the rostrum by the President of the Exchange, in the presence of about 250 brokers (*fols. 201–3, Plaintiff's Exhibit 9*).

This came right out on the ticker and gave wide publicity to the suspension (*fol. 595*).

Letter to the National City Bank.

At the same time that this letter was sent to the New York Stock Exchange, Lathrop, Haskins & Co. sent another letter to the defendant. Henry Petersen, a boy in the employ of Lathrop, Haskins & Co., took the letter to the bank between 11:30 and 12:30—close on to twelve o'clock. He gave the letter to a man sitting at one of the desks in the bank (*fols. 276, 275*). When Petersen left the office it had been rumored that Lathrop, Haskins & Co. had failed. He was anxious to ascertain whether such was the case, and therefore glanced over the shoulder of the man who was reading the letter he had presented and noted its contents (*fol. 276*). The letter consisted of little more than a line (*fol. 279; Plaintiff's Exhibit 9*). The letter showed a permanent rather than a temporary condition of

financial difficulty. This letter neither Mr. Kilburn, the vice-president, nor Mr. Albeck, the assistant cashier of the bank, recalled having seen, although their testimony on this point is uncertain (*fols. 474–5*).

Knowledge of the Bank, shown by the Testimony of Mr. Kilborn.

Mr. Kilborn went to the office of Lathrop, Haskins & Co. with Mr. Albeck, the assistant cashier of the National City Bank, on the afternoon of January 19th. Before he went there he was told that Hocking stock, in which Lathrop, Haskins & Co. were heavily interested, had "declined heavily," and that they were in financial trouble and on the verge of some kind of insolvency (*fols. 472–3*). Although the books showed a credit balance in favor of Lathrop, Haskins & Co. of over $390,000 at the time he went to their office, Mr. Kilborn did not wait until three o'clock to give them the usual opportunity to take up the $500,000 notes, the amount of their loans from the bank on that day (*fols. 489–496*).

There was a great deal of excitement in the office when Mr. Kilborn got there (*fol. 460*). Mr. Kilborn told Mr. Haskins and Mr. Leverich that the bank had certified checks for $150,000 more than their actual deposits, and in view of the situation of their firm and their being in trouble, he insisted that that $150,000 be made good (*fol. 479*). He did not ask for money to make good their obligations, although he would have taken it. He asked for securities to make good the obligations of Lathrop, Haskins & Co. (*fols. 483–4*). They told him they were in financial trouble and that they were absolutely forced to the wall (*fol. 492*). They told him the reason of the financial trouble and about the break in the Hocking stock (*fol. 491*). While he was in their office and before he received the securities, he was told that the suspension of Lathrop, Haskins & Co. had been announced on the floor of the New York Stock Exchange, and he knew that the

form of that announcement was that they were unable to meet their obligations (*fols. 481–2*).

He obtained the securities some time before 2:30 o'clock and gave a receipt for them (*fol. 457, Complainant's Exhibit 13, fol. 444*).

Knowledge of the Bank as shown by Testimony of Mr. Albeck.

Mr. Albeck, the assistant cashier of the National City Bank, testified that he noticed the drop in Hocking stock on the morning of the 19th of January after Lathrop, Haskins & Co. had obtained their $500,000 loan from the bank (*fol. 589*). He knew that Lathrop, Haskins & Co. were heavily interested in the stock, and that Hocking was one of their specialties (*fols. 589, 609*). He called Mr. Kilborn's attention to the drop in the securities and informed him that the bank had loaned Lathrop, Haskins & Co. $500,000 that morning. He examined their deposits and told Mr. Kilborn that the "difference" amounted to about $117,000. Mr. Kilborn suggested that they go down to see Lathrop, Haskins & Co., which they did (*fol. 606*), between 11:30 and 12 o'clock (*fol. 587*). They went to protect the bank in case there was a failure (*fol. 591*).

Mr. Albeck thought the situation was a very alarming one and called for immediate action on the part of the bank in order to protect itself. They wanted to see the bank's obligation taken care of, paid or secured at the earliest possible moment (*fols. 607–8*). It was an urgent matter, calling for immediate action (*fol. 608*). Their object in going was that the bank should be secured in case Lathrop, Haskins & Co. had to fail or go into bankruptcy (*fol. 591*).

Mr. Kilborn spoke to Little and Haskins and said that they had noticed that Hocking Coal & Iron Co. stock was breaking badly and they came over to see what condition the firm was in (*fol. 597*). They asked payment of their indebtedness; asked for money or security, but

Mr. Albeck does not remember that anyone told him that they had no money (*fol. 604*). They were told to wait. Mr. Little and Mr. Haskins told them that Lathrop, Haskins & Co. could not go on because of what happened to Hocking stock (*fol. 596*), and that under the conditions they could not meet their obligations (*fol. 597*), that they would be forced to the wall by what had happened. Mr. Albeck understood that to mean that Lathrop, Haskins & Co. would fail in business (*fol. 598*).

While at Lathrop, Haskins & Company's office and before they received the securities Kilborn and Albeck learned that the suspension of the firm had been announced on the Stock Exchange (*fol. 588*).

At *folios 591–3* of the record Mr. Albeck testified as follows :

> "You went there to protect yourself in case there was a failure, didn't you ? A. Yes.
>
> Q. So that you would be secured in case Lathrop, Haskins & Co. had to fail or go into bankruptcy ; that was your object in going up there ? A. Yes, sir.
>
> Q. And after you got there and heard of their suspension you did then expect their failure ? A. Well, not necessarily.
>
> Q. You had a reasonable ground to believe that they were going to fail or become bankrupts ? A. Not necessarily.
>
> Q. No ; but you did, didn't you ? A. No.
>
> Q. Wasn't that a fair expectation ? A. Suspensions do not always mean failures.
>
> Q. But in most cases they do, don't they ? A. In most cases, yes.
>
> Q. But at the time the suspension was announced you knew as a matter of certainty that they (Lathrop, Haskins & Co.) could not meet their obligations ? A. Yes, sir."

During the first hour that they were waiting at the office of Lathrop, Haskins & Co., a member of that firm told Mr. Kilborn and Mr. Albeck that an application was being made to the Court for the appointment of a receiver of the

firm ; that this application had not yet been granted (*fols. 609–10*).

> " Q. Did anybody tell you a Receiver had been applied for ? A. Yes, but he had not been appointed.
>
> " Who told you ? A. I cannot say; it was one of the firm——
>
> Q. While you were waiting there during the first hour they said an application was being made to the Court to appoint a Receiver of the firm ? A. Yes, sir.
>
> Q. And it had not yet been granted? A. It had not yet been granted "(*fol. 609*).

Finally, after a wait of about two hours, Kilborn and Albeck were handed the securities and gave a receipt for them and left directly for the bank, which was about three or four minutes' walk from Lathrop, Haskins & Company's place of business. They arrived at the bank about 2:30 (*fol. 552*).

KNOWLEDGE OF THE DEFENDANT AS DISCLOSED BY TESTIMONY OF MR. LITTLE.

Mr. Little was the attorney for Lathrop, Haskins & Co., and was in their office all afternoon on the 19th of January, 1910 (*fol. 211*). Mr. Kilborn and another gentleman came into the office between 1 and 1:30 P. M. Little saw Kilborn as soon as he came in (*fol. 214*). Kilborn stated that he had heard of the break in Hocking stock and of Lathrop, Haskins & Company's trouble and wanted payment of the bank's obligations (*fol. 215*). Little told Kilborn that Lathrop, Haskins & Co. were insolvent and that a petition in bankruptcy was either filed or being filed against them, and that they could not pay anybody (*fol. 216*). Little went into the financial condition of the firm of Lathrop, Haskins & Co. very fully with Kilborn. He explained the whole situation about the pool with Keene, went into the details of the pool, and told Kilborn that Lathrop, Haskins & Co. would lose $2,000,000 (*fol. 221*).

Little told Mr. Kilborn that Lathrop, Haskins & Co. could not meet their obligations and that in paying the bank they were doing something they ought not to do (*fol. 222*). Little debated that question with Kilborn for nearly two hours. Lathrop, Haskins & Co. were old customers of the bank and desired its good will. Mr. Little wanted the relations between the bank and Lathrop, Haskins & Co. as friendly as possible and that was the motive that inspired him in directing delivery of the securities to Mr. Kilborn (*fol. 218*). When he gave the securities to Kilborn, Little told him that it was a clear preference, was preferring the bank over other creditors, but that the securities could not be in a safer place than with the National City Bank (*fols. 219–20*). Little is positive in his testimony that he gave Mr. Kilborn his securities after the close of the Stock Exchange, *i. e.*, after three o'clock that afternoon (*fol. 240*).

Filing of Petition in Bankruptcy.

The petition in bankruptcy against the firm of Lathrop, Haskins & Co. and the individual members thereof was filed at 10 minutes past 4 o'clock on the afternoon of January 19th, 1910, less than 2 hours after the bank received the securities in suit, according to the testimony of Mr. Albeck, its assistant cashier, and less than an hour after Mr. Little testified that the securities were given to Mr. Kilborn (*Complt.'s Ex. 1; fols. 552, 240*).

If ever there was a case where a trustee established beyond question a creditor's reasonable cause to believe that a preference was intended, this is that case.

The bank had actual knowledge that Lathrop, Haskins & Co. were insolvent, yet the statute does not require actual knowledge, but only that the creditor shall have reasonable cause to believe that a preference was intended.

> *Loveland on Bankruptcy, 3rd ed., p. 561;*
> *Remington on Bankruptcy, Secs. 1398–1399;*
> *Bardes* vs. *The Bank, 122 Iowa, 443; 12 A. B. R., 771;*

Sundheim vs. *Ridge Avenue Bank, 138 Fed. Rep., 951; 15 A. B. R., 132;*
Parker vs. *Black, 143 Fed. Rep., 560; 16 A. B. R., 202;*
Re Hines, 144 Fed. Rep., 543; 16 A. B. R., 495;
Wetstein vs. *Franciscus, 133 Fed. Rep., 900; 13 A. B. R., 326;*
Pratt vs. *Columbia Bank, 157 Fed. Rep., 137; 18 A. B. R., 406.*

In *Pratt* vs. *Columbia Bank, 157 Fed., 137,* Hough, *J.*, said:

> "The meaning of the words, 'reasonable cause to believe' has been too often subject to decision to require extended citation of authority. Knowledge is not necessary nor even belief, but only reasonable cause to believe, which is a different thing (*Bank* vs. *Cook, 95 U. S., 343*)."

The existence of a general financial crisis should put a prudent man upon inquiry with reference to doubtful debtors.

Clarke vs. *Daughtrey, 10 Nat. Bank. Reg., 21* (not elsewhere reported).

In accepting the securities in the face of this complete knowledge of the firm's financial condition, the bank was simply taking its chances.

Intent on the part of the debtor to give a preference need not be shown by affirmative proof, but flows from the knowledge of insolvency on the part of the debtor.

Pirie vs. *Title Co., 182 U. S., 438, 454; 45 L. ed., 1171;*
Benedict vs. *Deshel, 177 New York, 1;*
Alexander vs. *Redmond, 180 Fed., 92; 24 A. B. R., 620.*

In *Alexander* vs. *Redmond* (*24 A. B. R., 620, 623; 180* Fed., *92*), Lacombe, *J.*, said:

"We do not think the intent of Boorn & Co. is material, because the statute expressly provides that a transfer by an insolvent person within the four months' period shall be deemed to be a preference of its effect shall be to enable any creditor to obtain a greater percentage than others of his class. The result of the transfer and not the mental attitude of the transferror is made the test."

IV.

The defendant has failed to establish the custom pleaded, and has failed to establish any valid custom or usage.

The complainant has established all the elements necessary to prove a preferential payment or delivery of securities, with practically no denial of any of the material facts by the defendant.

It cannot be fairly claimed that the element of custom or usage in any way affects the delivery to the defendant, on the afternoon of the 19th of January of the securities that were not in any loans on that day, and were not therefore obtained or released with the use of checks drawn by Lathrop, Haskins & Co. and certified by the defendant. A list of those securities has been set forth.

As to such securities therefore the complainant having established a preference under the Bankruptcy Act, is entitled to a decree directing the payment of their reasonable value, in their return.

A Custom of Usage Must be Proved by Facts and Instances and Not by Opinion and Understanding.

Before describing in detail the testimony of defendant's various witnesses to establish custom or usage, we point out that the material part of such testimony is wholly made up of the opinion and understanding of the

witnesses, what they now say was *expected* by them and their banks in a transaction similar to that in controversy.

Such testimony is not competent to establish a custom or usage.

Defendant invokes a claimed usage as a part of the contract. A usage cannot be proven by the opinion of witnesses as to the law or as to what should be a rule. It cannot be proven by the opinion or understanding of witnesses. It must be shown solely by specific instances that have been acquiesced in.

> *Home Ins. Co.* vs. *Weide, 78 U. S., 438 ;*
> *The John H. Cannon, 51 Fed. Rep., 46 ;*
> *Ames Co.* vs. *Kimball Co., 125 Fed. Rep., 332 ;*
> *Allen* vs. *Bank, 22 Wend., 145, 223 ;*
> *Mills* vs. *Hallock, 2 Ed. Ch., 651.*

In *Mills* vs. *Hallock* (*2 Ed. Ch., 651, 655*), McCoun, *V. C.*, said :

> "The difficulty about the testimony on the part of the complainant is that it amounts to no more than the mere opinion or private understanding of authorities.
>
> A custom must be proved by evidence of facts (and not by mere speculative opinions) by means of witnesses who have had frequent and actual experience of the custom.
>
> The testimony of those who speak from report only and not from particular instances within their own knowledge if receivable at all is of no weight (*4 Starkie, 452*). The witnesses here do not speak of particular instances within their own knowledge where the right to reclaim goods has been asserted on the ground of such conditional delivery and been acquiesced in by purchasers. There is no evidence of facts. No evidence that the purchasers have had frequent and actual experience of the custom ; and without this I cannot say the custom exists."

In *Ames Co.* vs. *Kimball, 125 Fed., 232*, De Haven, *D. J.*, at *page 335*, says :

"The defendant sought upon the trial to show a local usage at the port of Nome exempting persons engaged in lightering merchandise from liability for loss or damage to such merchandise occasioned solely by perils of the sea, but the evidence offered was not sufficient to establish such a usage. No witness testified to any instance in which such a usage had been recognized and acted upon by the parties interested, when goods had been lost or damaged by perils of the sea while being lightered to the beach at Nome. Two witnesses stated generally that there was such a usage; but one seems to have based his statement upon the fact that he had previously entered into an agreement with the North Coast Lighterage Company to do lighterage for him, in which it was agreed that the lighterage company was not to be liable for damage or loss of goods while in transit from the ship to the shore; and the other, upon conversation he had had with persons engaged in the business of lightering, in which he was informed by them that they would not be responsible for loss or damage occasioned by perils of the sea. This evidence is certainly not sufficient to establish a usage. 'Usage is a matter of fact, not of opinion. Usage of trade is a course of dealing; a mode of conducting transactions of a particular kind. It is proved by witnesses testifying of its existence and uniformity from their knowledge obtained by observation of what is practiced by themselves and others in the trade to which it relates' (*Haskins* vs. *Warren, 115 Mass., 535*). And in *Duer on Ins., Vol. I, page 182*, it is said :

'The existence of a usage, whatever may be the nature of the subject to which it relates, is in all cases a fact; a complex fact, it is true, resulting from a variety and a succession of individual acts, but still a fact, to be proved like all other facts, by the testimony of witnesses speaking from their personal knowledge. It is not created by hypothetical opinions, but by actual practice, and can only be established by a series of acts of a similar character

and import, performed at different times, by different persons. It is to these acts that the testimony, properly restrained and directed, should be strictly confined, and it is upon their number, uniformity, and notoriety that the weight and value of the evidence depends. Hence, where a witness swears generally that a particular usage exists, yet is unable to state from his own knowledge any instance of its actual observance, his testimony should at once be rejected; and it is only by a strict adherence to this rule that the important distinction between the evidence of opinions and belief and that of fact is possible to be maintained.'"

In *re Cannon* (*51 Fed.*, *46*), MORRIS, *D. J.*, at page 47, says:

"In the present case it would seem that what is spoken of as a usage was, in fact, rather the prevailing belief among underwriters and adjusters in Baltimore that the general law did not recognize the right to contribution for jettison of a deck cargo of lumber. It was rather a local understanding of the general law than a local usage of trade, the cases being so few and infrequent that no usage could be said to be established by them."

In *Home Ins. Co.* vs. *Weide* (*78 U. S.*, *438*), Mr. Justice DAVIS, at *page 439*, says:

"As this case will have to go back for a new trial, and as the point was raised in the Court below, it may be proper to observe that no witness can be asked what the course of trade is, in reference to this particular business. This *would be either opinion or hearsay*. He can only be allowed to tell his personal experience on the subject about which he is called to testify. It is only through the aggregated testimony of all the witnesses that the fact can be proved which so connects itself with the plaintiff's business as to require from him an answer."

All of the testimony of witnesses called to prove the custom, who testify, merely, to their opinion as to the rights of third parties under circumstances which never occurred before, should therefore be entirely disregarded.

Course of Dealing Between Lathrop, Haskins & Co. and the Defendant.

Lathrop, Haskins & Co. had but one bank account, and that with the National City Bank. For some time prior to January 19, 1910, they sent their demand notes to the bank daily in varying amounts. These notes were all similar in form and substance to the demand notes sent on the morning of the 19th of January, 1910 (*Complt.'s Exhibits 11 and 12*), providing among other things that the bank was to have a lien for its advances on *all securities in its possession* belonging to the brokers, with the right at any time to demand additional security (*fol. 439*).

The demand notes were brought in daily at about ten o'clock in the morning, and the amounts thereof credited to the account of Lathrop, Haskins & Co., added to their balances on hand, and entered in their pass-book just as in the case of any loan with collateral (*fols. 411, 437, 402, 619*).

In this account were also credited the deposits made in the course of the day of receipts from all sources (*fol. 434*).

Lathrop, Haskins & Co., drew checks to anybody they pleased against their balances with the bank (*fol. 620*).

They deposited in their account with the bank all of the moneys received by them in the course of the day, including, of course, moneys they received for stocks delivered on that day (*fol. 434*).

At the close of the day they sent their check for the entire amount of the day's demand note, and the bank would return their note stamped "paid" (*fol. 411*).

Each day a new demand note would be delivered and each day that note would be paid off by three o'clock in the manner stated (*fol. 412*). The bank never knew what

transactions Lathrop, Haskins & Co. had the day before. Lathrop, Haskins & Co. would say they wanted a certain amount of money to clear their loans. What these loans were they did not specify, nor so far as appears from the testimony did the bank know what securities were held as collateral thereto (*fol. 622*).

Mr. Albeck, the bank's assistant cashier, testified that the loan made by the bank to Lathrop, Haskins & Co. on the morning of January 19th, 1910, was known as a clearance loan (*fol. 618*).

But so far as the course of dealing between the bank and Lathrop, Haskins & Co. is concerned there is no evidence to show for what purposes the proceeds of such notes were used by the latter. The defendant alleges that Lathrop, Haskins & Co. applied for a loan on the 19th of January, 1910, to meet their *current obligations* and to pay for stocks purchased and obtain the release of securities deliverable by them on that day.

It would seem, therefore, that the use of the proceeds of those notes was in no way limited or restricted to paying off loans, the words *current obligations* being broad enough to include Lathrop, Haskins & Co.'s office expenses and any of their debts whether secured or otherwise.

Mr. Albeck testified that the bank expected deposits to be made within a reasonable time after the demand notes were accepted by the bank and that the bank's idea was to have deposits made as quickly as possible. If deposits were not made within a reasonable time the bank would call up the brokers to ascertain the cause of the delay (*fol. 624*).

There is no claim that any such demand for deposits was ever made upon Lathrop, Haskins & Co.

Not one specific instance is pointed out where the bank asserted a lien on any of the securities in the possession of the bankrupts obtained by means of checks certified by the bank or otherwise.

So far as the course of dealing between the bank and the bankrupts is concerned all that has been shown is that a

new loan would be made daily by the bank on a demand note of the bankrupts, which would be paid at the close of the day by the latter's check.

The defendant has not established that the use of the proceeds of the demand notes was limited and restricted.

There is not a bit of evidence that would tend to show any custom or usage by which the bank was to have a lien on any securities or other property in the hands of the bankrupts to secure the demand loan.

The Custom as Testified to by Mr. Kilborn.

Mr. Kilborn, vice-president of the defendant, testified that it was the custom in Wall street that banks furnish a credit so that brokers can clear their stocks. It is a credit which is extended so that they can pay up their loans and take up securities they have purchased, with the understanding that this credit is to be made good, either by check or *the placing of a loan with the bank to make good the credit extended to them* (*fol. 486*).

This testimony simply amounts to a statement that the demand loan was to be paid in some way or other before the close of the day. There is nothing in the custom or usage, as testified to by Mr. Kilborn, that in any way tends to show that the bank was to have a lien on securities in the possession of the brokers or that there was any agreement for the bank to have any such lien.

It was to be paid by check or by the placing of a new loan with the bank. There is not even a suggestion that the securities obtained with the proceeds of the demand note were to be delivered to the bank either in payment of or as collateral security therefor.

It is significant also that the custom or usage which the answer alleges applied to banks in the City of New York is now limited and restricted to banks in Wall street.

Mr. Carse's Version of the Custom or Usage.

Mr. Carse, the vice-president of the Hanover National Bank, has a more comprehensive conception of the custom or usage sought to be established.

> "The broker in the morning figuring up the amount of stocks or securities he has to pay for or the loans that he has to turn over, makes up a demand note for a round amount and sends it up to our loan desk with his passbook; we make a loan for the amount, enter it in the passbook and credit it on the ledger; a memorandum of this amount is made on the certification book, together with the amount of balance to the credit of the account at the opening of business, and from time to time during the day any deposits that are made for the credit of the account and against such credits we certify checks that are presented during the course of the day by the broker. When the day's work is cleared up the broker sends up a check to the loan clerk for the same amounts as the notes. We stamp the note paid and return it to him, and the check going through the books as a charge, offsets the credit that was made on the loan in the morning" (*fol. 560*).

In the case of small customers only the bank would ask them to specify on the back of the note what securities they were going to clear (*fol. 676*).

The deposits made by brokers to whom the demand loan is made are not labelled in any way and the bank cannot tell whether the checks deposited were received by the brokers on transactions for which he is supposed to have made the so-called clearance loan (*fol. 705*).

The bank does not care where the broker gets the money from to pay the demand loan so long as it is paid. Whether it comes from the particular transaction for which the broker is supposed to have made the demand loan or from other transactions makes no difference to the bank (*fol. 706*).

In order to pay off the demand loan, the brokers borrow

regular call money on the Exchange, sometimes from the very bank making the demand loan (*fol. 665*).

There was no case of which the witness has any knowledge where the securities to obtain which the demand loan was supposed to be made, were brought to the bank and simply kept as collateral security for the clearance loan.

There was only one case in all of Mr. Carse's wide experience where the securities for the release of which the day loan was supposed to be made were received and in that case the bank made a new call loan on the securities and the proceeds of the new loan were used to pay the clearance loan.

In all other cases the demand loans were paid in money or check (*fol. 605*).

It was the understanding that the broker should pay off the demand loans by *good certified checks and not by forcing loans on the bank* (*fol. 657*).

Mr. Carse's discussion of the legal effect of the transaction, his opinion and his conception of the understanding between the bank and broker with reference thereto are not competent under the authorities as proof of any usage or custom and should be disregarded (*fols. 655–7, 662*).

The answer alleges a custom or usage by which securities obtained with the proceeds of a demand loan were to be delivered to the defendant as security for that loan at the close of the business day.

The witness with his wide experience knows of no case where that was done.

The Custom or Usage as Testified to by Mr. Alexander.

At the very outset it should be borne in mind that the National Bank of Commerce, of which Mr. Alexander is vice-president, uses, in making so-called day and clearance loans, a form of demand note in which it is expressly provided that the securities obtained with the proceeds of the

note are to be held in trust for and deposited with the bank as follows (*Plaintiff's Exhibit 16, fol. 817*):

> "It is expressly agreed that the stocks, bonds, or other securities, or the proceeds thereof, purchased by the undersigned with, or which may come into possession or control of the undersigned, out of the moneys loaned by said bank, and evidenced by this note shall be by the undersigned, or its agent, or representative, held in trust for and deposited with said bank, it being the intention and agreement of the undersigned to pledge and deposit with said bank and to subject the lien and control of said bank as such pledgee the securities or moneys so acquired, as collateral to this obligation and to any other obligation or indebtedness of the undersigned to said bank."

Any testimony given by Mr. Alexander on the subject of day loans is based, not on any custom or usage, but on the express written contract that his bank makes with its customers, which is entirely different from the contract made between the bankrupts and the defendant.

In fact, the use of that express agreement is strongly indicative of the fact that there is no custom or usage for the bank to have a lien on securities in the possession of the broker, but that it is a matter of contract solely. The witness testified that he did not think that the forms used by the different banks were uniform (*fol. 761*).

There was just one case in the experience of this witness where the loan was not paid during the day. In that case the broker had his securities locked in the vault, and Mr. Alexander obtained a trust receipt for the securities, which specified them in detail, and made a new call loan on them.

Mr. Alexander was not willing to let the broker keep the securities overnight under the day loan agreement. The reason he assigns for this is that he wanted the loan to bear interest overnight, is hardly convincing, when as a Wall street man Mr. Alexander undoubtedly knew that any demand loan bears interest from the time of a demand (*fols. 786, 791*).

Methods of Other Banks.

The First National Bank and the Bank of the Manhattan Company, two banks in Wall street, making so-called day or clearance loans enter into a written contract with the broker by which the latter agrees to hold certain specified securities obtained with the proceeds of the day loan in trust for the bank (*fols. 825, 836*).

If there is a custom or usage so well known and commonly accepted, so definite and certain as is urged by the defendant, why do two of the large Wall street banks find it necessary to make an express written agreement upon the subject?

The Alleged Custom or Usage is not Uniform.

It is clear that no two banks consider the custom or usage the same. Each bank has a different agreement, and beyond the hope and belief that the money loaned is to be repaid from some source each bank has a different custom or method of doing business and a different expectation (*Adams* vs. *Otterback*, *15 How.*, *539*).

The securities were not separated or marked.

The securities cleared or paid for by the proceeds of the loan were indistinguishably mixed with all of the securities in the possession of Lathrop, Haskins & Co., and they drew from the mass for any and all purposes indiscriminately. And when the bank received the securities in suit pursuant to their demand they received securities from the mass without discrimination as to source. To say now that there was a contract for a lien arising by usage is to accuse the officers of the bank of acting with a laxity surprising.

The notes specify the security. The demand notes provide that the bank shall have a lien upon all securities in its possession and the right to demand additional security. This effectively negatives the claim that by contract the bank was to have a lien upon securities not in its possession.

The Custom or Usage is in Conflict with Well-Settled Principles of Law.

The law is clear that he who desires security must have possession, constructive or actual, of the securities. A vague agreement to secure is never enforced where bankruptcy intervenes. No reason is shown here why the rule of law should not apply (*Corn Exchange Bank* vs. *Nassau Bank, 91 N. Y., 74*).

The Securities in Suit were not Delivered to Defendant, Pursuant to any Custom or Usage.

During two-hours' wait for securities not one word was said about the bank's right to the securities by virtue of any custom. The bank asserted no claim to the securities, but asked for them as a matter of favor. The bank did not know what securities were received with proceeds of the demand note. It did not ask Lathrop, Haskins & Co. to account for such securities, to tell them what had become of the securities the bank was entitled to.

The bank asked for any and all securities the bankrupt had.

It had one motive only.

It wanted to be protected and secured.

Of the securities delivered to the bank a number were not even in loans on January 19th and had nothing to do with the demand notes of that day.

The bank's receipt contains nothing to indicate that the securities were the property of the bank.

No new loan was made by the defendant, as all of the witnesses called by defendant testify is usually done.

The defendant took the securities as collateral to demand notes, an occurrence which, according to the testimony of its own witnesses, is entirely unheard of.

V.

Any custom or usage for the bank to have a lien on securities in the possession of Lathrop, Haskins & Co. is inadmissible and incompetent, as tending to change and vary the terms of the written agreement between the parties (the demand notes).

Judge STORY said :

> "An express contract of the parties is always admissible to supersede, or vary, or control, a usage or custom: for the latter may always be waived at the will of the parties. But a written and express contract cannot be controlled, or varied, or contradicted by a usage or custom."
>
> *1837*, STORY, *J.*, *The Schooner Reeside*, *2 Sumn.*, *567*, *Fed. Cas.*, *No. 11,657.*

The express written agreement entered into by the bankrupt with the defendant is the two demand notes for $500,000.

They provide that the bank "shall have a lien upon all property of the undersigned now or hereafter in its possession or under its control, as security for any indebtedness of the undersigned now existing or hereafter contracted, with the right at any time to demand additional security, etc." (*fol. 439*).

The parties to the written contract have expressed themselves, definitely and explicitly, on the subject of the securities on which the bank was to have a lien. There is nothing uncertain, nothing doubtful or equivocal about the scope of the lien as thus expressed.

It is not to be presumed that the parties would provide in writing for a portion only of the security or for a lien on securities only that were in the possession of the bank, where a written provision for securities in the hands of the bankrupt was much more necessary and essential, if the bank's right to such additional securities was intended to be made effective by the parties.

A usage of the New York Stock Exchange cannot be proved to show that a person who has agreed to purchase stock within a certain time shall be entitled to dividends previously declared, because such usage would be inconsistent with the rules of law and contradict the plain terms and legal effect of the contract.

Hopper vs. *Sage, 112 New York, 530.*

Proof of a custom is not admissible to show that an absolute written contract to furnish all coal needed between certain dates was not to be binding in case of a strike.

Covington vs. *Coal Co. (Ky.), 89 S. W., 1126.*

Where an insurance policy provides that there be a proof of loss in writing, evidence of a custom to send a blank form therefor to the insured, when the company is notified of the fire, is not admissible to excuse the failure to make such proof.

Bomsyweski vs. *Co., 186 Mass., 589.*

THERE MUST BE AMBIGUITY OR UNCERTAINTY UPON THE FACE OF A WRITTEN INSTRUMENT ARISING OUT OF THE TERMS USED TO JUSTIFY EXTRANEOUS EVIDENCE OF USAGE, AND IT MUST BE LIMITED TO THE CLEARING UP OF THE OBSCURITY.

It is not admissible for the purpose of adding new stipulations to the contract.

O'Donohue vs. *Leggett, 134 New York, 40;*
Oelricks vs. *Ford, 64 U. S., 49;*
Barnard vs. *Kellogg, 10 Wall., 383.*

The contract was prepared and furnished by the defendant, and it is elementary that the words of an instrument are to be taken most strongly against the party employing them.

The contract provides specifically that the bank shall have a lien on securities in its possession. "*Expressio unius est exclusio alterius.*" Yet the bank seeks to invoke a custom and usage in this case which adds entirely new terms to the contract and one which gives the bank in addition an entirely different lien than expressly provided for in the contract, a lien on securities in the BROKER'S possession.

The contract shows a loan. To add a provision thereto that the bank is to have a lien on the proceeds of the loan not only adds to and varies the express provisions of the written contract, but is absolutely repugnant to its legal effect.

Where the parties have chosen to prescribe for themselves the terms and conditions of the loan they must be held to abide by them.

The defendant contends that the rule which excludes parol evidence and usage to vary the terms of a written instrument, applies only between the parties to the instrument. That such rule does not apply between strangers to the instrument is true, but it is well settled that it applies *between the parties and their privies;* and those who claim through a party title or rights under the contract are privies within the rule.

This is right on principle. The parol evidence rule is one of construction only, and not of legal policy, and the construction determines the extent of the right which the party had and could pass on.

Selchon vs. *Stymus, 26 Hun, 145 ;*
Coleman vs. *Bank, 53 New York, 388 ;*
Wigmore on Ev., Vol. 4, § 2446.

VI.

The defendant has no equitable lien.

The securities were not separated or marked but were mixed with the general mass of securities in the bankrupt's possession. There was no agreement to separate or distinguish them in any way. The bankrupts drew from the mass indiscriminately. When the securities were delivered they were withdrawn from the mass without any reference to their source or to any substitution. Part of the mass had been cleared from loans and part had not, and those that had been so cleared, were cleared by checks drawn against an account representing monies from all sources.

> *Casey* vs. *Cavaroc, 96 U. S., 467;*
> *Torrance* vs. *Bank, Supreme Ct. of Kan., 71 Pac., 235, 11 Am. B. R., 185;*
> *Long* vs. *Bank, 147 Fed. Rep., 360;*
> *Johnston* vs. *Hoff, 133 Fed. Rep., 704;*
> *Pollock* vs. *Jones, 124 Fed. Rep., 163, 10 Am. B. R., 616;*
> *Bank* vs. *Johnson, Supreme Ct. of Neb., 10 Am. B. R., 208* (Not elsewhere reported);
> *Ryttenberg* vs. *Shefer, 137 Fed. Rep., 313;*
> *Matthews* vs. *Hardt, 79 App.Div., 570.*

In *Casey* vs. *Cavaroc, 96 U. S., 467*, the creditor bank gave acceptances against stocks and securities which were by agreement set apart as security and then re-delivered to the discount clerk to facilitate substitutions. The debtor bank failed and its receiver sued to recover for these securities which had been removed in contemplation of insolvency.

Bradley, *J.*, *page 488*, says:

> "The requirement of possession is an inexorable rule of law, adopted to prevent fraud and deception;

for, if the debtor remains in possession, the law presumes that those who deal with him do so on the faith of his being the unqualified owner of the goods."

In *Torrance* vs. *Bank*, *Supreme Court of Kansas*, *11 Am. B. R.*, *185*, a bank advanced money to enable a contractor to build a grain elevator, relying upon the promise of the contractor to repay the same out of payments on the contract price as it was paid. Within the four months' period the contract indorsed and delivered to the bank a draft received in part payment of the contract price.

GREENE, *J.*, *page 188*, says:

> "There is no provision in the statute protecting executory contracts for security. This question has been quite frequently before the courts under previous bankruptcy acts, as well as under State insolvent laws, and, while these statutes differed from one another and from the present bankrupt law, there was no material difference between them and the present law upon this question. It has been generally held that an agreement made when a debt is created to give security, but not consummated until within the period excluding preferences, is voidable by the trustee as preferential."

In *Long* vs. *Bank*, *C. C. A.*, *8th Cir.*, *147 Fed. Rep.*, *360*, the bank obtained as security an agreement from the bankrupt, who was conducting a small mercantile business, that he would dispose of his stock and pay the bank, and to carry an insurance of $7,000, and an assignment of sufficient insurance money, in case of loss, to pay the bank. A loss occurred and the bankrupt paid the bank from insurance moneys within the four months' period. It was held that the bank had no equitable lien and the payment was a preference.

In *Johnston* vs. *Huff*, *C. C. A.*, *4th Cir.*, *133 Fed. Rep.*, *704*, one White was boarding the laborers engaged in building a railroad. Pay for the board was made by the rail-

road by deducting the amount from the wages and paying the same to White. White obtained credit for the necessary supplies from Huff by giving as security an order on the railroad for all moneys that might be due to him. Sometime later White defaulted and the order was presented one day before the filing of the petition in bankruptcy. It was held that Huff had no equitable lien upon the moneys in the hands of the railroad due to White.

In *Bank* vs *Johnson, Supreme Court of Neb.*, *10 Am. B. R.*, *208*, the bank as security for a present advance took a mortgage on 76 described steers. They were a part of a larger number and separation and appropriation was made within the four months' period. The appropriation was held a voidable preference.

When the bank certified the checks it had under the most favorable construction of circumstances only a vague sense of safety because the proceeds would likely be in the hands of the brokers. The transactions of the day made the complete change and the credit could not be extended and then withdrawn. The claims of the other creditors arise very largely from the transactions of that day, and they, too, did not intend to give credit for more than a day. They expected that their transactions would be completed in due course as among brokers.

Where a lien on goods sold and delivered as security for the purchase price is expressly contracted for and fails for want of possession or separation, or because the purchaser was permitted to consume or sell the goods, the seller is entitled to no equitable lien upon the goods remaining in the hands of the buyer or upon proceeds thereof. And where in such case possession or separation comes within the four months period the transfer takes place as of that date.

Re Liberty Silk Co., 172 Fed. Rep., 535;
Pontiac Buggy Co. vs. *Skinner, 158 Fed. Rep., 858;*
Fourth St. Bank vs. *Milbourne Mills, 172 Fed. Rep., 177;*

Re Faulhaber Co., 170 Fed. Rep., 68 ;
Skilton vs. *Codington, 185 New York, 80 ;*
Re Dismal Swamp Co., 135 Fed. Rep., 415 ;
Re Charles Klingaman, 101 Fed. Rep., 691, 4 Am. B. R., 254.

In re Liberty Silk Co., 172 Fed. Rep., 535, HOUGH, *D. J.*, says :

"The wholesome rule is summarily stated in *re Gracewich, 115 Fed. 87*, that when property is delivered to a vendee for consumption or sale, or to be dealt with in any way inconsistent with the ownership of the seller, the transaction cannot be upheld as a conditional sale, and is a fraud upon the creditors of the vendee."

An express promise to pay out of a given fund is not an equitable assignment of that fund and is not effective against the trustee in bankruptcy of the promissor.

Christmas vs. *Russell, 81 U. S., 69 ;*
Williams vs. *Ingersoll, 89 New York, 508 ;*
Dillon vs. *Barnard, 21 Wall., 430 ;*
Smedley vs. *Speckman, 157 Fed. Rep., 815.*

Sexton vs. *Kessler, 172 Fed., 535; 225 U. S., 90*, is plainly distinguished from this case by the following features :

(1) There was an express agreement in writing purporting to give a specific lien on specified securities.

(2) The securities were actually designated, specified and set apart. The creditor was notified of what securities had been set apart, and also of any changes from time to time as made.

(3) The debtor treated the stocks as appropriated and subject to a superior lien. In the present case the debtor with perfect right treated the securities as his absolute property. Lathrop, Haskins & Co. never dreamed that the defendant had a lien on those securities, nor did the

defendant either, apparently, and no lien was acquiesced in on delivery, but delivery was made with an allegation of preference and for purposes of safe keeping.

VII.

The doctrine of equitable subrogation is not applicable to this case.

Reference is made to the treatment of this aspect of the case by the learned Special Master (*fols. 976, et seq.*).

The doctrine of equitable subrogation applies where a party is compelled to pay the debt of a third person in order to protect his own rights or to save his own property.

The doctrine of subrogation requires:

First.—That the person seeking its benefit must have paid a debt to a third party before he can be substituted to another's rights. *Second.*—That in doing this he must not act as a volunteer but on compulsion to save himself from loss by reason of a superior lien or claim on the part of the person to whom he pays the debt, as in the case of a surety or a prior mortgagee.

> *Ætna Co.* vs. *Middleport, 124 U. S., 534;*
> *Schimm* vs. *Budd, 14 N. J. Equity, 234;*
> *Sanford* vs. *McLean, 3 Paige, 117.*

In *Ætna Co.* vs. *Middleport, 124 U. S., 534*, MILLER, *J.*, said:

> "One of the principles lying at the foundation of subrogation in equity in addition to the one already stated, that the person seeking this subrogation must have paid the debt is that he must have done this under some necessity, to save himself from loss which might arise or accrue to him by the enforcement of the debt in the hands of the original creditor; that, being forced under such circumstances to pay off the debt of a creditor who had some supe-

> rior lien or right to his own, he could, for that reason, be subrogated to such rights as the creditor, whose debt he had paid, had against the original debtor."

In order that one having no interest to protect who pays the debt of another or advances money for the purpose may be entitled to succeed to the rights of the creditor in respect to the debts so paid, *there must be a convention or agreement to that effect.*

In *Bowder & Co.* vs. *Hill, 136 Fed. Rep., 821,* LURTON, *J*, said at *page 823* :

> "The mere fact that one pays off a debt at the instance of the debtor or lends money to pay off such debt does not entitle him to subrogation to the liens of the creditors so paid off.
>
> The subrogation may result from a direct agreemsnt between a debtor and a third person who pays the debt, that he shall be subrogated to all the rights and securities existing in behalf of the creditor whose debt is paid off, but nothing short of an express agreement to that effect will move a court of equity in behalf of such a creditor.
>
> *A mere understanding upon the part of such a third person under no obligation to pay the debt, that he by such payment will be subrogated to the liens of the creditor is not enough.*"

In the case at bar the equitable doctrine of subrogation has no application for the following reasons :

(1) The agreement of loan in no way limits the use of the moneys.

(2) There was no breach of contract by the bankrupts in applying the moneys as they did.

(3) There was no agreement for subrogation.

(4) The securities cleared were used by the bankrupts without distinction.

(5) It is unknown to what extent the securities were under pledge, and hence to what extent they were cleared.

(6) It is unknown to what extent the moneys that cleared the securities came from the loan and to what extent they came from the bank balance and deposits of the bankrupts with the defendant.

(7) The other claims against the estate arose largely from transactions entered into that same day and it would be inequitable to prefer defendant.

VIII.

Measure of Damages.

Complainant is entitled to recover $154,300, the value of the securities at the date of delivery, with interest to the date of the final decree, April 11, 1912, and interest on the decree.

If the Court allows the defendant to return the securities with the dividends, the defendant should be charged with interest on all dividends received.

The final decree purports to follow the Master's report, but fails to do so in that the alternative money judgment is nearly $1,000 less than what it should be, based on the Master's report.

Since there has been a further depreciation of the securities subsequent to April 11, 1912, the time of the final decree, the court should provide that the defendant should be charged with such depreciation. This is loss pending the appeal.

Defendant claims to still hold the securities delivered, and claims the right to return the securities with the dividends received, and compel the loss from depreciation to fall on the estate.

At the date of delivery, January 19, 1910, the securities had a conceded value of $154,300 (*fols. 131, 287*). On April 5, 1910, the date of the stipulation to effect their

sale, they were worth $149,706.25 (*fols. 1182–3*). On April 25, 1910, the date of confirmation of that stipulation, they were worth $144,918.75 (*fols. 1182–3*). On October 17, 1910, the date of the Master's report, they were worth $116,287.39 (*fol. 1047*). On February 26, 1912, the date of the hearing before the Master on the accounting, they were worth $116,568.75 (*fol. 1184*).

The depreciation from January 19, 1910, to February 26, 1912, is over $37,500. The interest on $154,300 for the same period is above $19,000. The dividends received during the same period amount to little over $9,000 (*fol. 1154*).

The securities were all "listed" and hence could readily have been disposed of at any time. They were also of speculative nature and subject to fluctuation.

The bank at first deposited the 200 shares of Hocking Coal & Iron Company under the plan of reorganization of that company. It later withdrew the same and refused to participate, and this stock is absolutely worthless (*fol. 1046*), and the bank would tender it back. The trustee took part in the re-organization to the extent of the shares held by him and now holds stock of considerable value.

The bank has been drawing dividends on these stocks and hence must have transferred them to itself.

(*a*) The Bankruptcy Act.

The statute gives the trustee the right to recover the value of the securities or the securities themselves at his election.

§ 60*b* provides:

> "If a bankrupt * * * shall have made a transfer, and if at the time of the transfer * * * the transfer then operate as a preference * * * *it shall be voidable by the trustee and he may recover the property, or its value from such person.*"

The natural and legal meaning of these words is that the

trustee shall have the election to recover either the securities or their value.

> *Collier on Bankruptcy, 8th ed., 1910, p. 675.*
>
> *In re Phelps, 3 A. B. R., 396*; (not elsewhere reported.)

> "The option of suing for the property or for its value rests with the trustee. These words (property or its value) are doubtless merely expressive of the rule of law. The judgment should include interest from the date of the preference. In most cases the value, *i. e.*, damages, is demanded. This in effect ratifies the title which passed through the preference."
>
> *Collier on Bankruptcy, 8th ed., 1910, p. 675.*

The action is one in equity for an accounting. The demand for relief simply follows the words of the statute, and demands judgment,

> "decreeing that the transfer * * * be set aside, and that the defendant deliver up to the complainant herein *all of the said securities so transferred or the value and proceeds thereof, etc.*"

It is elementary that in this form of action the complainant need not charge the defendant until the defendant had rendered its account. Disclosure of the disposition made of the stocks and of the profits or losses realized or sustained therefrom must precede the precise formulation of complainant's claim.

The defendant is in the position of one who wrongfully withholds property of the complainant with respect to which it cannot make a profit and for which it must fully account in equity. It is a trustee *ex maleficio*.

If the securities had appreciated in value and they had been sold, the complainant could claim the proceeds, and if they had not been sold, could demand their return.

(*b*) AUTHORITIES.

The circumstances are aggravated by the fact that the defendant knew when it took the securities that a petition in bankruptcy was about to be filed and a receiver was about to be appointed on that very day, and all this, in in fact, did occur upon that day.

The complainant cannot be made to suffer, nor can the creditors of the bankrupt's estate be made to suffer because the defendant wrongfully took securities to which it had no right or claim.

> *Ommen* vs. *Talcott, 175 Fed. Rep., 261.*
> *Houghton* vs. *Steiner, 92 App. Div., 171.*
> *Crampton* vs. *Valido Co., 60 Vt., 291.*

In *Ommen* vs. *Talcott* (*175 Fed. Rep., 261*), the trustee in bankruptcy in a suit in equity was seeking to charge a preferred creditor with the value at the time of delivery of merchandise delivered to said preferred creditor and constituting a preference. The goods had been sold under a contract between the receiver and the creditor. In sustaining such contract, HAND, *J.*, says:

> "If the receiver gave up no rights, the defendant got no protection from the contract, because without it he had the power to sell off the stock. He would have been in no worse situation without the contract than with it, for without it the complainant could have done no more than elect to charge him with the value, or the proceeds according as it was to his interest and to refuse to allow him his expenses, and that is precisely what he wishes to do, as it is. On the other hand, the obvious purpose of the receiver, as the contract states, was to get the stock sold as soon as possible. While it is true that he might have thrown out the credits if the defendant sold or held the defendant for the depreciation of the goods, if he did not, the defendant might have preferred to let the stock remain unsold and fight the issue of depreciation, instead of real-

izing upon the goods and being obliged to lose all his expenses.

*   *   *   *   *   *   *

By December 19, 1902, the defendant had received clear intimation that the receiver regarded his possession as wrongful, for he attempted by summary order to obtain possession. It is, of course, quite true, at least in theory, that a subsequent trustee might not agree with the receiver, but I am satisfied that the defendant took his chances in retaining possession after that time, and that no demand was necessary. From then on he became a trustee *ex maleficio*, having seized from the estate property which he had no right to retain and which he knew was being claimed."

In *Crampton* vs. *Valido Marble Co., 60 Vt., 291* (a case involving a preference under the Vermont Insolvency Act), VEASEY, *J.*, said :

"We think there was no error in the instructions to the jury as to the rule of damages. It was the value of the property at the time the defendant took it."

The Bankruptcy Act of 1867, § 35, was as to the point involved substantially identical with § 60*b* herein referred to, and, therefore, the decisions under that Act are applicable here.

First National Bank vs. *Jones, 88 U. S., 325.*

Shuman vs. *Fleckenstein, Fed. Cas., 12826.*

In *First Nat. Bank* vs. *Jones (88 U. S., 325)*, Mr. Justice CLIFFORD, *page 545*, says :

"That the measure of damages is the value of property seized and sold by virtue of the execution issued on the judgment obtained against the debtor.

Instead of that it is contended by the defendants that the amount realized by the defendants is conclusive as to the value of the property seized and sold ; but the plaintiff was not a party to that proceeding, and the express provision of the Bankrupt

Act is that the assignee may in such a case recover the property, or the value of it, from the person so receiving it or so to be benefited by it. Sold as the property was at a judicial sale, it cannot be recovered in specie and the only remedy of the assignee is for value of it, and no doubt is entertained that the rule prescribed as the measure of damages by the Circuit Court is correct."

In *Shuman* vs. *Fleckenstein* (*Fed. Case, 12826*), the assignee in bankruptcy sued at law to recover the value of goods transferred as a preference. The defendant demurred and set up for cause the want of an allegation of demand for the return of the goods. DEADY, *D. J.*, notes that the original taking was not wrongful and that it required wrongful retention to make it so, and says:

> "The assignee is as much entitled to recover damages for an injury to, or detention of, the goods as to recover the possession of them, and under the Code as well as at common law such damages may be recovered in the action to recover possession.
>
> Although the bankrupt act declares that the assignee may recover the property or its value, it is to be construed as giving the right to recover the latter, only as a substitute for the former in cases where the property has been destroyed or passed beyond the control of the creditor, or *been constructively converted to his own use by a refusal to deliver the same upon a due demand of the assignee*. In the latter case the assignee has the *option to sue for the property or the value*. But an action to recover the value of property can only be maintained when the property itself has been actually or constructively converted to the use of the defendant, and the complainant must therefore allege a conversion in terms or its legal equivalent—a demand and refusal."

Where the trustee sues the preferred creditor at law for conversion it is well settled that the measure of damages is the value of the property at the time of taking.

Stern vs. *Meyer*, *99 App. Div.*, *427*.
Merritt vs. *Halliday 107 App. Div.*, *596*.

It is well settled that this is one way in which the complainant in a suit in equity may charge the defendant, and

there is no reason why equity should not follow the law in this particular kind of case.

(*c*) THE VALUE OF THE SECURITIES SHOULD BE TAKEN AS OF THE DATE OF THE TAKING JANUARY 19, 1910.

The defendant by its answer seeks to justify the taking of the securities.

In a similar case, *Bank* vs. *Jackman* (*204 U. S., 522, 524*), Mr. Justice McKENNA said:

> "The bank, it is true, demurred to the complaint and urged as a ground of demurrer the absence of an allegation of a demand. But the bank did not stand on the demurrer. It answered, and not only traversed the allegations of the plaintiff, but set up an independent defense, and showed that a demand would have been unavailing, and a demand is not necessary where it is to be presumed that it would have been unavailing."

Demand was made on defendant on February 18, 1910 (*fol. 1171*).

The letter of the receiver dated January 20, 1910, apprised the defendant of the claim of the estate, but did not constitute an election of remedies after the refusal of said demand (*fol. 1168*).

The defendant relied below upon the case of *Wasey* vs. *Holbrook* (*141 App. Div., 336*).

In that case the plaintiff asked for the return of the stocks and damages for the difference between the value of the stocks at the time of the taking and at the time of the judgment. The Court denied the right to recover the depreciation of the stock, but this decision is based, as will appear from the opinion, upon the failure of proof on the part of the plaintiff. The Court says:

> "The evidence does not clearly and satisfactorily establish the fact"

that there had been any depreciation (*see Opinion, p. 338*). The Court further found that

> "full and complete relief can be given the plaintiff by directing the appellant to return the certificates

> of stock in question and requiring him to account for any dividends or benefits derived from them during the time he held the same."

The situation is entirely different in the present case. The difference between the two measures of damages amounts to about $47,000.

The object of the Bankruptcy Act is not restitution merely, but full indemnity or compensation to the estate for the loss which it has suffered at the hands of a wrong-doer.

(*d*) STIPULATION OF APRIL 5, 1910.

On April 5, 1910, the securities had depreciated over $4,500 and the depreciation was continuing (*fol. 1182*). The bank and the trustee then entered into a stipulation for the sole purpose of effecting a sale, and the substitution of the proceeds to the position of the securities. This sale never took place and hence the rights dependent thereupon never accrued. The intent of the parties is shown by the following provisions:

> "It being the intention of the stipulation that the securities in the possession of ths National City Bank shall be converted into money at the best prices obtainable, and that all rights of the parties shall remain against the proceeds of the sale of the said securities the same as they existed against the securities themselves at the time of the making of the stipulation."

The whole scope of the stipulation is to effect a sale. In case of no sale the stipulation is entirely inactive.

Again, "such sales to be without prejudice to the rights of either the bank or the trustee, etc.,"; and "this stipulation shall not alter the rights or claims of any of the parties."

To hold that complainant has stipulated away his right to charge defendant for depreciation, although there has been no sale, is both contrary to the plain meaning of the

stipulation taken as a whole, and contrary to the express intent as well.

Considering the stipulation as taking effect upon a sale only, it has a reasonable meaning, as the estate prevents further depreciation and to an extent liquidates its claim, but to consider it as taking effect in case of no sale is to give the stipulation the effect and meaning of subjecting the estate to the acts of the bank without possible advantage in return. It would be a mere gratuity. This is a forced and unreasonable construction.

The stipulation was not to obtain the discretion of the officers of the bank. The estate without the stipulation could charge the bank with the value of the securities if it did not sell, and could charge it with the selling price if it sold and it was advantageous so to do.

The terms "may be sold by the bank * * * at such times as may seem best to the officers of the bank" allowed the bank a reasonable time to sell pursuant to the stipulation. This phase does not have the force to entirely change the purpose of the stipulation, and allow rights to accrue which are expressly stipulated to accrue only on a sale—"this stipulation shall not alter the rights of any of the parties."

This stipulation to sell has been perverted into a stipulation not to sell. It is not that the bank may sell or not and the estate shall be precluded from recovering for depreciation. It is that the bank shall sell within a reasonable time, and if it does the proceeds shall be substituted for the securities.

This stipulation was designed to protect the bank in the event of a sale, but in no other event.

Reasoning of the Court.

In the opinion confirming the Master's report upon the trial of the action, the District Court said :

> "This is a suit in equity to recover the actual securities in specie: that is the prayer, and that was

what was intended. It is quite likely that the trustees may have had the right to sue at law after rescinding the transfer and making demand, because the refusal would have been a conversion. However, he did nothing of the kind, but proceeded in equity to reclaim his securities, and he cannot now blow hot and cold. The decree will be for the delivery of the securities with any dividends received upon them" (*fol. 1120*).

Upon the accounting the Master considered himself bound by this expression of the court (*fol. 1219*).

It is submitted that the foregoing is a misconception of the action. In the first place, the complaint follows the statute and the complainant need not elect how he would charge the defendant until the accounting.

In the second place, the action is brought in equity to rescind the transfer, and the complainant could charge defendant with the value at time of the transfer, with interest. The Court seems to feel, temporarily, that because the action was in equity the purpose must necessarily be to recover back the *res in specie*. The Circuit Court of Appeals overruled this view and should have reversed the case on the measure of damages (*p. 340*).

The District Court then held that under the stipulation of April 5, 1910, complainant could not charge defendant with the depreciation of the securities. The Court says: "To construe the stipulation" so as to charge the bank with loss in case of no sale "would be to produce the greatest incentive to an immediate sale. The purpose of the stipulation was certainly not that, but to get the advantage of the bank's best judgment as to the time to sell."

This reasoning, of course, is based upon the previous holding that because the action is in equity the complainant must take back the securities, however depreciated, if the defendant wishes to tender them. Only from such a position is there any sense in saying that the trustee gained anything by having the bank's judgment on the time of sale, for otherwise the trustee could charge defendant with

the value of the securities, or with their proceeds in case of an advantageous sale.

The Circuit Court of Appeals held that defendant was chargeable with the value at the time of making, but for the stipulation (*p. 240*). The finding by the Master and confirmance thereof by the Court that the stipulation changed the rights of the parties, was due to their prior holding that the action was to recover the securities only, and when this later was reversed, the decree should have been reversed on the measure of damages (*fols. 1120-1, 1219, 1226*). The force given to the stipulation was due to their idea that the securities in specie were complainant's only claim, and hence he was interested in obtaining the bank's discretion as to the time of sale. From their point of view the complainant was claiming under the stipulation instead of the defendant, when the rights dependent on the stipulation never, in fact, took effect.

It is submitted that the Court overlooks the fact that the express purpose of the stipulation was to effect a sale and the stipulation was to take effect only in the event of sale. Such construction does not give the "greatest incentive to an immediate sale," but to a sale within a reasonable time. This gives full effect to the words "may be sold * * * at such time as may seem best to the officers of the bank," taken with the rest of the stipulation and the express intent of a sale and substitution of the proceeds The opinion is silent as to that part of the stipulation which provides "the making of this stipulation shall not alter the rights or claims of any of the parties" (*fol. 1192*).

Of course the sale would work a substitution, but the stipulation was not to alter any rights.

The defendant claimed all the securities from the time of taking. No demand was necessary. Demand was made on April 19, 1910 (*fol. 1211*). The bank seized upon all securities available and took by far the greater part of the marketable securities in the hands of the broker at that time, and has continually held them in defiance of

any claim by the trustee. As to certain of these securities it had no claim of lien. The taking of the securities prevented the sale and caused a loss, and defendant took its chances and should be charged therewith under any theory of the action.

Depreciation Prior to April 5, 1912.

This amounted to $4,593.75 (*fol. 1182*). On March 8, 1910, the trustees wrote to the defendant suggesting a stipulation (*fol. 1200*). On March 9, 1910, defendant answered suggesting that the trustee prepare a form (*fol. 1204*). On March 30th a stipulation was submitted to defendant's attorneys (*fol. 1206*). On April 5th defendant's attorneys excuse their delay and send the signed stipulation to the attorneys for complainant (*fol. 1208*). As to this the Court says: "The trustee "had put the matter in train for settlement *quoad* the time of the sale" (*fol. 1246*), and hence could not charge the bank for depreciation subsequent to March 8, 1910.

It is submitted that no waiver is made out. The bank was a converter. The parties were dealing at arm's length and there is no reasonable ground for claiming that the stipulation took effect before April 5, 1910. And then it provides that it shall not alter any rights (*fol. 1192*).

Alternative Judgment.

The error into which the Court fell in adopting the measure of damages is illustrated by the alternative judgment (*fol. 1281*). For while the Court held that the defendant might tender back the securities with dividends and interest on the same, it also held that unless the defendant did so the plaintiff should recover the value of the securities at date of transfer ($57,300) plus interest on the same from the date of the report (October 17, 1911), plus the amount of dividends and interest received, with interest on the same from date of receipt to the date of the report (*fols. 1003–4, 899*). After allowing the defendant to

tender back the securities and dividends at its option, an alternative judgment is provided that is a hybrid and founded on no real basis.

Errors of Calculation.

The amount of the alternative judgment, $161,740.62 (*fols. 1281, 1003*), is obtained by adding $8,137.50+$3.12+$154,300, and should be $162,440.62 (*fols. 899–900*). To this is to be added interest on $154.300 from October 17, 1911, according to the report on the trial of the action.

The final decree, although intended to follow the Master's report, fails to charge defendant with interest on dividends and interest received by defendant (*fols. 1280, 1003–4*).

Depreciation since April 11, 1912.

The stocks delivered were of the value of about $104,-700 on September 30, 1913. There has been a depreciation of about $12,000 subsequent to April 11, 1912, the date of the final decree, and this depreciation should be charged to the defendant.

IX.

The decree should be modified so as to allow the complainant to recover $154,300 with interest from January 19, 1910. In all other respects the decree should be affirmed.

October, 1913.

Respectfully submitted,

Abram I. Elkus & William A. Barber,
Solicitors for Complainant, Appellee and Appellant.

Abram I. Elkus and
Wesley S. Sawyer,
Of Counsel.

NATIONAL CITY BANK OF NEW YORK *v.* HOTCHKISS, AS TRUSTEE IN BANKRUPTCY OF HASKINS.

HOTCHKISS, AS TRUSTEE IN BANKRUPTCY OF HASKINS, *v.* NATIONAL CITY BANK OF NEW YORK.

APPEALS FROM THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Nos. 459, 460. Argued October 17, 20, 1913.—Decided November 3, 1913.

Courts may go far in giving financial transactions between banks and customers any form which will carry out the mutually understood intent, *Sexton* v. *Kessler*, 225 U. S. 90; but if the intent is doubtful or inconsistent with the legal effect of dominant facts it will fail.

An understanding that the proceeds of a loan made by a bank to a customer and placed to the credit of his general account are to be used to take up certain securities does not, in the absence of any special agreement to that effect, create a lien upon those securities, and the delivery of such securities to the bank with notice of the customer's impending insolvency is an illegal preference under the Bankruptcy Act.

A trust cannot be established in an aliquot share of a man's whole property, as distinguished from a particular fund, by showing that trust monies have gone into it.

Although a loan may be made for a specified purpose, if the lender places it in the stream of the borrower's general property there is no right of subrogation.

A general creditor may increase the bankrupt's estate by his advances and lose the right to take them back.

Time may sometimes be disregarded when it is insignificant, but not where it has sufficed to materially change the financial positions of the parties.

These cases are distinguished from *Gorman* v. *Littlefield*, 229 U. S. 19, and other cases in which there was a specific *res* which identified the fund and separated it from the general mass of the estate.

A notice to a bank demanding securities for a loan made to the bank-

rupt that bankruptcy was impending and that it was receiving a preference is sufficient to show that the bank had cause to believe that it was obtaining a preference.

Under an agreement, made in a suit by a receiver against a bank to recover securities in specie as an illegal preference, that the bank should hold them pending the decision of the suit with a power to sell in its discretion which had not been exercised, *held* that the bank was only liable for the securities and not for their value at the time the agreement was made.

201 Fed. Rep. 664; 120 C. C. A. 92, affirmed.

THE facts, which involve the determination of whether the delivery of securities by a broker, immediately preceding his bankruptcy, to a bank to secure its loan was an illegal preference, are stated in the opinion.

Mr. John A. Garver for appellant in No. 459 and for appellee in No. 460:

The law presumes an agreement or transaction to be legal, when it is capable of a construction which makes it valid. Jones on Evidence (2d ed.), § 85; *King* v. *Hawkins*, 10 East, 211; *Curtis* v. *Gokey*, 68 N. Y. 300, 304; *Ormes* v. *Dauchy*, 82 N. Y. 443.

So as to securing a just debt. *Getts* v. *Janesville Co.*, 163 Fed Rep. 417; *Re Neill Co.*, 170 Fed. Rep. 481, 484; *Re Leech*, 171 Fed. Rep. 622; *Sexton* v. *Kessler*, 172 Fed. Rep. 535, 537.

The right to recover a preference is exclusively statutory. The common law favors the diligent creditor. *Tompkins* v. *Hunter*, 149 N. Y. 117, 121; *Dodge* v. *McKechnie*, 156 N. Y. 514, 520; *Huntley* v. *Kingman*, 152 U. S. 527, 532.

A trustee in bankruptcy has, therefore, no power to avoid a preference, except on the precise grounds specified in the statute; and, as the right given is in derogation of the common law, it must be strictly pursued. Plowden, Comm. 113; Sutherland, Stat. Con., § 371; *Atkins* v. *Kinnan*, 20 Wend. 241, 249, 250.

A remedy which is given by statute must be strictly followed. *East Tenn. &c. R. Co.* v. *Southern Tel. Co.*, 112 U. S. 306, 310; *Campbellsville Lumber Co.* v. *Hubbert*, 112 Fed. Rep. 718, 724–750; affd., 191 U. S. 70; *Matter of Bryce*, 16 Daly, 443.

A transaction, such as this, which does not diminish the fund distributable among the creditors is not repugnant to the statute. *County Bank* v. *Massey*, 192 U. S. 138, 147; *Bank of Newport* v. *Herkimer Bank*, 225 U. S. 178, 184; *Gorman* v. *Littlefield*, 229 U. S. 19, 25; *Continental Trust Co.* v. *Chicago Title Co.*, 229 U. S. 435.

This rule applies even where the account is not active and where two payments have been made without any intermediate sale. *Re Sagor*, 121 Fed. Rep. 658; *Jaquith* v. *Alden*, 189 U. S. 78; *Yaple* v. *Dahl-Milliken Co.*, 193 U. S. 526; *Wild* v. *Provident Trust Co.*, 214 U. S. 292, 296.

There are no other creditors of the same class.

A payment is objectionable under § 60 only when it has the effect of enabling one creditor to obtain a greater percentage of his claim than other creditors of the same class. *Swartz* v. *Fourth Natl. Bank*, 117 Fed. Rep. 1; *Crooks* v. *People's Bank*, 46 App. Div. 335.

The classification referred to in § 60*a* is not the same as that providing for a priority in the payment of debts in § 64*b*. As to differences in classification, see *Re Belknap*, 129 Fed. Rep. 646; *Re Barrett*, 6 Am. Bkcy. Rep. 199; *Re Harpke*, 116 Fed. Rep. 295, 297; *Re Denning*, 114 Fed. Rep. 219, 221; *Gomila* v. *Wilcombe*, 151 Fed. Rep. 470.

There is no proof that the bankrupts intended to give preference.

Prior to the amendment of 1910, the trustee in bankruptcy was required to prove, in a suit of this kind, that the creditor knew that the bankrupt actually intended to give a preference. *Hardy* v. *Gray*, 144 Fed. Rep. 992; *Re First Natl. Bank*, 155 Fed. Rep. 100 (C. C. A. 6th); *Bank* v. *Graves*, 156 Fed. Rep. 168; *Tumlin* v. *Bryan*, 165

Fed. Rep. 166; *Re Leech*, 171 Fed. Rep. 622; *In re Sayed*, 185 Fed. Rep. 962; *Kimmerle* v. *Farr*, 189 Fed. Rep. 295; *Debus* v. *Yates*, 193 Fed. Rep. 435. As to the effect of the amendment, see *Alexander* v. *Redmond*, 180 Fed. Rep. 192, and cases cited in brief for appellant, in *Mechanics Bank* v. *Ernst* (*post*, p. 64).

Defendant did not have reasonable cause to believe it was obtaining a preference. *Irish* v. *Citizens' Trust Co.*, 163 Fed. Rep. 880.

The conduct of defendant's officers in asking for the securities on that day is entirely consistent with the understanding and usage of the business, and is in direct accord with the written contract, that clearance loans shall be taken care of before the close of business hours.

Subrogation exists. The tendency is to extend subrogation to every possible case for the protection of one advancing money for discharging obligations carrying security. *Matthews* v. *Fidelity Title Co.*, 52 Fed. Rep. 687, 689.

Subrogation is allowed in every instance in which one party pays a debt for which another is primarily liable, and which, in equity and good conscience, the latter should have discharged. *Stevens* v. *King*, 84 Maine, 291; *Dunlop* v. *Adams*, 174 N. Y. 411, 416; *Atlantic Trust Co.* v. *Kinderhook Co.*, 17 App. Div. 212; *Louis* v. *Bauer*, 33 App. Div. 287, 293; *Peters* v. *Meyer*, 72 App. Div. 585; *Gans* v. *Thieme*, 93 N. Y. 225; *Pease* v. *Egan*, 131 N. Y. 262, 273; *Moorehouse* v. *Bklyn. Heights Co.*, 185 N. Y. 520, 524; *Title Guarantee Co.* v. *Haven*, 196 N. Y. 487; *Lidderdale* v. *Robinson*, 2 Brock. 159, 168.

The only exception is that it will not be applied to defeat the superior or equal equities of third persons. 4 Pom. Eq. Juris. (3d Ed.), § 1419, *note; Union Tr. Co.* v. *Monticello R. R. Co.*, 63 N. Y. 311, 314.

The bankruptcy courts should apply the doctrine recognized in the state courts. *Hewitt* v. *Berlin Works*, 194 U. S. 296; *Thompson* v. *Fairbanks*, 196 U. S. 516;

Humphrey v. *Tatman*, 198 U. S. 93; *Sabin* v. *Camp*, 98 Fed. Rep. 974.

Equity will not permit technicalities or even serious obstacles to stand in the way of the enforcement of the principle of subrogation. *Peters* v. *Meyer*, 72 App. Div. 585; *Gans* v. *Thieme*, 93 N. Y. 225; *Pease* v. *Egan*, 131 N. Y. 262; *Cobb* v. *Dyer*, 69 Maine, 494.

It is not necessary that the person to be subrogated should pay the creditor directly. It is sufficient if he advances the money for the purpose of enabling the debtor to pay the debt. *Building Assn.* v. *Thompson*, 32 N. J. Eq. 133; *Merchants' Bank* v. *Tillman*, 106 Georgia, 55; *Sgobe* v. *Cappadonia*, 8 App. Div. 303; *Peters* v. *Meyer*, 72 App. Div. 585.

The proceeds of the loan constituted a trust fund. *Sexton* v. *Kessler*, 172 Fed. Rep. 535, 544.

This loan was made in conformity with an established custom between banks and their broker customers. A general custom is the common law itself, or a part of it; even written contracts will yield to such custom. *Walls* v. *Bailey*, 49 N. Y. 464, 471; Elkus on Secret Liens, 83, § 150.

There was a special fund held by the bankrupts for a specific purpose, to be used in protecting and enhancing the value of the general assets, and having, consequently, such character that no general creditor could claim any right to share in it. *Gorman* v. *Littlefield*, 229 U. S. 19, 25; *Fourth Street Bank* v. *Yardley*, 165 U. S. 634.

Mr. Abram I. Elkus, with whom *Mr. Wesley S. Sawyer* was on the brief, for appellees in No. 459 and appellants in No. 460.

MR. JUSTICE HOLMES delivered the opinion of the court.

This is a suit by a trustee in bankruptcy to recover certain securities alleged to have been transferred to the

defendant bank by way of preference. The plaintiff had a judgment in the District Court, 200 Fed. Rep. 287, *id.* 299, and in the Circuit Court of Appeals, 201 Fed. Rep. 664; 120 C. C. A. 92. Both parties appeal; the plaintiff upon a subordinate question as to its right to elect damages instead of a return of the securities.

The case arose upon what is known in New York as a clearance loan. Brokers need large sums to clear or pay for the stocks that they receive in the course of the day, and as the stocks must be paid for before they are received and can be pledged to raise the necessary funds, these sums are advanced by the banks. They are returned later on the same day by making deposits to the borrower's account and drawing a check to the order of the bank. Perhaps such a general course of dealing might be arranged so as to give a lien on the loan or its proceeds until payment, but the question whether such a lien has been created rarely, if ever, has arisen, the whole business being finished in a few hours. It is, however, the main issue in this case.

The bankrupts were brokers in partnership and at ten o'clock on January 19, 1910, had assets exceeding their liabilities by nearly half a million dollars. These assets consisted largely in the stock of a coal and iron company in which there was a pool. Before twelve, there was a break in the market, the stock went down and at about noon the suspension of the firm was announced. A petition in involuntary bankruptcy was filed at ten minutes after four on the same day. At about ten, the bank made a clearance loan to the bankrupts of $500,000 in the usual way to enable them to meet their current obligations and to get the stocks deliverable on that day, the bank receiving demand notes and both parties acting in good faith. The sum was credited in the deposit account of the firm, in addition to $54,319.98 already there, and soon after the bank certified and subsequently paid checks amounting